1-1-1963

Corporations

Maynard Jackson

CORPORATIONS

PROF DE JARMON

55¢

NORTH CAROLINA COLLEGE

NORTH CAROLINA COLLEGE AT DURHAM
TRUTH
SERVICE
DURHAM, N.C.

No. 4375-SW
College Ruled and Margin Line

75 Sheets

Name MAYNARD HOLBROOK JACKSON, JR.

Course

The Canteen
NORTH CAROLINA COLLEGE
DURHAM, NORTH CAROLINA

Name Cases

(p. 31)

Flournoy v. 1st Nat. Bank of Jeffersonville

In a trade acceptance situation, the acceptor (D^{or}) of a trade acceptance is absolutely liable to the P^{ee} and cannot raise any defense against P^{ee} that he (D^{ee}) may have had against the D^{or}.
See secs. of N.I.L. 136, 137, 150, 151.

(p. 59)

Kessler v. Valerio

In a suit by P^{ee} v. Maker (on a P.N.), the P^{ee} need no longer plead and prove consideration. The B/P re failure or lack of consid. is on the D. — the D can raise fraud or failure of consid. or lack of consid. against P^{ee} (after showing non-negot. of the note), but not against a holder in due course. N.I.L. 24 and 28.

(p. 87)

Miller v. Race

Title to a bearer instrn. can be passed by delivery alone. Thus, even a thief can pass title to a bearer instrn. (includes instrn. w/ blank indorsement). (Dictum: title to an order note can only be passed by indorsement and delivery.

(p. 108)

Ward v. Evans

Rule of evidence: only is a precedent debt, as here, the mere taking of the note is not absolute pymt. But, if the debt is a concurrent one, the presumption (rebuttable) is that the note was taken in absolute pymt. — This rule applies only to a third party bearer note only is a precedent debt. NOTE: If a 3rd party bearer note qualifies as legal tender, pymt. therewith is absolute. e.g., money.

(p. 405) **Canal Bank v. Bank of Albany**

A Dee - bank can recover in Restitution against a forger - cash receiver only was a forged indorsement.

(p. 446) **Price v. Neal**

A Dee is deemed to know the Drawer's true signatures. i.e., A Dee is not entitled to recovery in Rest. on a forged DRAWING against the cash receiver. (An exception to the general rule allowing recovery in Rest.)

Met. Nat. Bank v. Loyd (p. 739)
Ct. of Apps. of N.Y. 90 N.Y. 530 (1882)

Action: on the instru. Inᵉᵉ v. Maker.
Facts: Pᵉᵉ blank ind. ✓ + delivered it to Merchants + Mechanics' Bank. That bank accepted the ✓ and credited Pᵉᵉ w/ the face amt. Merchants Bank transf. for value and before maturity to P. ✓ was dishonored (probably) by non-pymt.
D's argument: P has no title ~~but is merely an agent for +~~ because its transferor had no title because the transferor to P, Troy (Merchants) Bank was a holder of the ✓ as the agent of Pᵉᵉ for collection for his account, and that in case of non-pymt. it should be returned to Pᵉᵉ + the credit cancelled.
Issue: whether a depositor of a ✓ who receives credit therefor as cash ~~passes~~ title to the check ~~to the~~ depositary bank contingent upon the later pymt. of the ✓.
Held: No. Affirmed.
Reasoning: When a check is deposited w/ a bank, and credit therefor as cash is extended by the bank and taken by the depositor, the prop. in the ✓ passes from the depositor to the depositary bank. A right to the cash credit immediately arises in the depositor; and, as a practical matter, the bank has purchased the ✓, and the power and right to confer a perfect title upon a subsequent transferee.

Nat. Deposit Bank v. Ohio Oil Co. (p. 743)
250 Ky. 288, 62 S.W. 2d 1048 (1933)
Action: Inᵉᵉ – depositary bank v. Maker on the instru. (?)
Facts: Payee presented agents ✓ on corporate principals (D's) account to P- bank. P cashed the ✓ as Inᵉᵉ subject to K clause and credited Pᵉᵉ w/ the face amt. of ✓ on 7-18-28. On

7-26-28, D^re notified P that D had stopped pymt. on ✓. Before notice, P^es had drawn three ✓s totaling $4,895.30 and these were paid by P. Also, before receiving notice, P^es drew 2 ✓s on P and these ✓s were placed to credit of the P^es thereof, and certs. of deposit were issued and delivered to them.

"P^ee's ✓" was dishonored by D when presented to D, and D v. P to recover ~~face~~ value of ✓. Neel & Stewart v. P for honor of their certs. of deposit.

(1) D's argument in certs. of dep. case - the payees were not entitled to the amts. of the ✓s because their accounts were credited conditional upon pymt. of their drawer's (Libs) ✓ from Oil Co.

(2) D's argument in Oil Co. case - due to K clause on deposit slip of Libs, P took the ✓ merely for collection, and ∴ did not have sufi title to maintain suit in its own name.

Issues: (1) Whether when a ✓ is presented to a bank for deposit, ~~[illegible]~~ unqualifiedly accepted by the bank and placed to the credit of the depositor, such bank can thereafter repudiate the transaction?

(2) Whether a bank wh receives a ✓ for deposit and credits the depositor's acct. to that amt., is a holder of such ✓ entitled to bring an action thereon in its own name?

Held: (1) No.

(2) Yes.

Affirmed

Reasoning: (1) This rule is true absent fraud or collusion.

(2) Ou value has at any time been given for the instrument, the holder is deemed a holder for value in respect to all parties who became such prior to that time; and ou the holder has a lien on the instrm., arising either from K or by implication of law, he is deemed a holder for value to the extent of the lien.

NORTH CAROLINA COLLEGE AT DURHAM

SCHOOL OF LAW

Final Examination

CREDIT TRANSACTIONS

Mr. Shimm May 20, 1964

~~Part II~~

I.

Aaron Axe owned a farm, one-half of which he worked himself and one-half of which he leased to others on a share-crop basis. On his farm, he maintained facilities for storing, processing, and selling his own produce as well as that of such of his tenants and neighbors who wished to avail themselves of these services for a fee.

On July 1, 1960, to finance modernization of his food storage, processing, and selling operations, Axe borrowed $100,000 from the Bevel Bank. As security, he concurrently executed to the Bank a twenty-year mortgage on his farm, which was duly recorded, and which provided, inter alia, that the whole loan should become due in the event of a default in the payment of any installment of interest or principal, taxes, or insurance premiums; that the rents and profits of the property were to be assigned as additional security, and that the Bank would be empowered, in the event of a default, to take possession of the property and collect them; that a receiver should be appointed in the event of a default to collect the rents and profits and apply them to the debt; and that all property, real, personal, or mixed, then owned by Axe or owned by him during the continuance of the liability should be subject to the mortgage.

As Axe prospered, he continued to improve his farm and its related enterprises, which appreciated in value to $250,000. On March 29, 1964, however, a fire swept through his plant, seriously damaging the buildings and equipment and totally destroying the crop that had recently been harvested and stored by him, his tenants, and his neighbors. In the ensuing confusion, he inadvertently failed to pay to the Bank the quarterly installment of principal and interest that became due on April 1, 1964.

At this point, the financial outlook for Axe was not bright. Since, through unfortunate oversight, he had neglected to keep his property fully insured, it appeared that he would not recover more than forty per cent of the conservatively estimated $200,000 loss that he had sustained. Further, since his personal resources were insignificant and the likelihood of his securing additional capital was remote, his ability to restore the plant to efficient operating condition was doubtful. Finally, since there was evidence that the fire had been caused by the negligence of one of his employees, it was highly probable that substantial claims would be filed against him by those whose crops had been incinerated and whose losses would not otherwise be recompensed.

Aware of these facts and apprehensive about its security, the Bank on April 13, 1964, filed a bill praying both that its mortgage be foreclosed and that a receiver of rents and profits be appointed. On April 14, 1964, Axe tendered the pretermitted payment plus interest to the Bank, which refused to accept it.

Axe now comes to you, apprises you of the complete situation, and asks the following questions:

(1) Can the Bank foreclose the mortgage?

(2) If so, how, if at all, can he avert foreclosure?

(3) What property is subject to the mortgage?

(4) Pending foreclosure, can a receiver of rents and profits be appointed?

(5) If so, what rents and profits can be reached?

(6) If so, what disposition can be made of these collected rents and profits?

Prepare a memorandum discussing these points fully.

II.

For many years, the citizens of Dry Gulch, an incorporated village, had hauled their water from the neighboring village of Swampy Hollow, some thirty-one miles distant. They wanted their own well, however, and so the Mayor and Board of Selectmen voted to have one drilled and appropriated $10,000 for this purpose.

On the strength of indications supplied by his dowsing rod, Elmer Edge, a well-digger, agreed with the Mayor and Board of Selectmen to drill a municipal well of specified capacity for a flat fee of $10,000. The contract provided, inter alia, that "payment is to be made in the following manner: eighty per cent of the amount of labor and material in place in said well on the first day of each month, the final payment to be made when the well is fully completed per specifications." As was required by state statute, Edge furnished the usual public contractor's bond, on which his brother-in-law, Fred File, and the Gimlet Guaranty Company were sureties. A condition of the bond was that in case of default of the contractor, the sureties should have the right to complete the contract and be subrogated to the rights of the contractor as to "all deferred payments, retained percentages," etc. To indemnify File against possible loss, and thus induce him to sign the bond, Edge, unbeknownst to Gimlet Guaranty Company, gave File a mortgage on a tract of land he owned in the county, valued at $2,000, which was promptly recorded.

Edge drilled for two months, at the end of which financial difficulties forced him to stop. He had reached a depth of 3,500 feet without striking water; he had put $12,000 in labor and materials into the well, and although he had received $9,600 in progress payments, outstanding claims for labor and materials furnished for the well amounted to $4,000; and other creditors with claims aggregating $5,000, among whom was Harry Hammer, who held Edge's past due note of $1,500, were pressing him vigorously for payment.

Gimlet Guaranty Company, becoming somewhat alarmed at this juncture, notified the village of Dry Gulch to commence proceedings immediately against Edge for breach of contract. The Mayor was off on a hunting trip, however, and the Board of Selectmen, unsure of its authority was reluctant to initiate any action. Shortly thereafter, Hammer commenced suit against Edge on the note, recovered a judgment, and levied execution thereunder on all of Edge's nonexempt free assets.

At this point Gimlet Guaranty Company comes to you, apprises you of the complete situation, and asks your advice on these questions:

(1) To whom, if anyone, is it liable on its bond?

(2) To what extent, if at all, is it liable on its bond?

(3) What rights and remedies, if any, does it have against anyone?

Prepare a memorandum discussing these points fully.

M. H. Jackson

Final Examination

CORPORATIONS

Mr. LeMarquis DeJarmon May 20, 1963

I leave at ~~9:15~~ 9:15

"Incorporated Under the Laws of North Carolina

"Preferred Stock

"Number 98 Shares: Ten

"The Lyon Mills Company

"Capital Stock $ 75,000

"The preferred stock evidenced by this certificate shall be entitled to a dividend of seven per cent (7%) per annum which the Corporation guarantees. In case of the winding up of the affairs of the Corporation, all shares of preferred stock shall be paid before payment of any shares of common stock.

"The Corporation reserves the right to take up this preferred stock at any time after three years from the date of this certificate by paying the holder the face hereof and the accumulated dividends.

"This is to certify that D. R. Alter is the owner of ten preferred, cumulative, non-voting shares of the capital stock of the Lyon Mills Company, transferable only on the books of the Corporation in person or by attorney on surrender of this certificate.

"In witness whereof, the duly authorized officers of this Corporation have hereunto subscribed their names and caused the corporate seal to be hereunto affixed at Durham, North Carolina, this the 9th day of February, A. D., 1958.

[SEAL] The holder hereof shall be entitled to receive the face value, plus accumulated dividends upon the surrender of this certificate on or after February 9, 1961, upon thirty days' notice in writing of the holder's intention to surrender this certificate.

W. B. Boyce, Secretary
G. C. Schumacher, Vice President

Shares: $100 each."

D. R. Alter brings to you a Balance Sheet of the Corporation which reads as follows:

Lyon Mills Company

Balance Sheet, ~~December 31, 1962~~

Assets			Liabilities		
Cash	$ 57,841		Due Bank	$ 30,000	
Notes Receivable	1,322		Accounts Payable	31,935	
Accounts Receivable	36,333		Accruals	35,526	
Inventory	100,906		Advance to Customers	71,738	
			Due to Officers	1,661	
Current Assets		$196,402			
			Current Liabilities		$170,860
Fixed Assets, Net	157,051				
Leasehold Improvements (2)	27,966		Serial Notes Payable	112,375	
Due from Officers	1,122				
Prepaid Items	2,189		Total Liabilities		283,235
Misc. Receivables	9,655				
Developmental Expenses	94,335		Net Worth		
Patent	1	292,319			
			Common Stock	30,000	
Total Assets		$488,721	Preferred Stock	30,000	
			Deferred Royalty Income	7,000	
			Capital Surplus	89,000	
			Earned Surplus	49,114	
			Total		$488,721

After an extended interview with Mr. Alter, you discover that the Fixed Assets of the Corporation were acquired in 1958 at a total cost of $71,481; that the Leasehold was acquired at the same time for a total cost of $15,727 and that Inventory, if carried on FIFO basis, would amount to $72,853.

Mr. Alter wants your advice in the following situations:

A. The Board of Directors has proposed a resolution to declare a dividend in cash or stock in the total amount of $30,000 of which amount 21% would be payable to preferred in satisfaction of the dividends due for years 1962, 1961, 1960. The Corporation had no earning in 1959 so the resolution does not provide any funds for that year.

1. Can Alter enjoin the payment of any dividend to common until funds are made available for the year 1959?

2. Can Alter enjoin the declaration of any dividend in cash at this time on grounds that such a declaration will be an illegal distribution of corporate assets?

3. If the resolution would declare the dividend as a stock dividend, would Atler's proposed injunction lie?

B. The Board of Directors has also adopted a resolution that it will call in and retire 30% of the outstanding preferred stock on February 9, 1963. Alter has been notified that he must surrender his proportionate amount of shares under the terms of his certificate. Can Alter, under these circumstances, successfully oppose this call by the Board? Discuss.

II 10:00

The Acme Poultry and Game Company was incorporated under the laws of State X for the purpose of "dealing in dressed poultry, game and country produce." The Board of Directors at a formal meeting decided to add a line of beverages in order to stimulate sales of the other products. By a vote of 5 to 1 and 1 abstaining, the Board adopted a resolution to stock for off-premises sales the products of Schlitz Brewing Company and to give a bond guaranteeing payment. The Schlitz Brewing Company delivered quantities of beer to the Corporation for a period of six years, when after a stormy protest by the shareholders the arrangement was terminated. Schlitz Company sued the Acme Corporation and its surety for the purchase prices of the beer and recovered a judgment in the amount of $23,250 plus interest.

George Gower, owner of ten shares of Acme stock, wants your advice as to whether he can bring an action against the Directors jointly and severally to recover the $23,250 plus interest which the Corporation had to pay to the Schlitz Company. What would you advise? Discuss.

III 10:45

The Cook Corporation is now bankrupt, and a receiver has been appointed to marshal assets. Pursuant to his appointment, the receiver called on Smith and Douglass to pay into the Corporation the difference between the face value of their stock ($150,000) and the amount that had actually been paid for the stock ($75,000).

At the same time Henry Green submitted to the receiver sworn claims for moneys advanced by him to the Corporation in the amount of $22,947.

The receiver refused the Green claim on the grounds that Green had been a Director of the company and that he knew the exact condition of the company. He knew that the stock had been issued to Smith and Douglass for property not of its value as it was purported to be. Therefore, there was no fraud as to him.

Smith and Douglass thereupon requested that the call as to them for $75,000 be reduced by $22,947, the amount denied on Green's claim. The receiver refused this request. Was the receiver's ruling defensible in each instance? Discuss.

IV 11:30

James Moss was President and Manager of Lasswell Printing Company, Inc., when he purchased from one Howie Duff the plant, etc., of the Duff Lithographic Company for the sum of $21,564. Later on his advice and influence, the Lasswell Printing Company, Inc., purchased this plant from him at the sum of $60,000. In the latter transaction, Moss did not disclose to the Corporation the amount he had paid to Duff for the plant.

Lou Davey, a minority shareholder in Lasswell Printing, has just discovered the above facts and seeks your advice on whether he should bring an action for an accounting for the difference between $21,564, which Moss paid, and the $60,000 which the Corporation paid. What is your advice? Discuss.

V 12:30

The defendant promoters, as sole shareholders and directors, sold to the corporation a system of vending merchandise, the instrumentalities employed in its operations, patents, business and good will, for 15,000 shares of no-par value common stock. The promoters had paid $1,000 for the rights sold.

The company immediately issued par value preferred stock to the public, and the 15,000 shares of no-par stock were sold through the company officials (the promoters) presumably as issued by the company for $100,000. After deducting certain expenses, the promoters split the remainder of the $100,000 among themselves.

In a suit to recover this secret profit, the court dismissed the action saying:

> "There was a full bona fide consideration for the sale by the company to the promoters of the 15,000 shares of no-par stock. Had this stock had a par value and had stock of par value exceeding the value of the rights purchased been issued, a different question would arise."

Can this decision be reconciled with Bigelow v. Old Dominion Mining or with Lewisohn v. Old Dominion Mining? Discuss.

(B) Rugg—

(L) Holmes (w/ Cardozo exception)

Fed. view

MR. DEJARMON

Baker and Carey - casebook.

HORNBOOKS:

Ballantine on Corps.

Lattin on Corps.

DEVICES - TO AVOID UNLTD. LIAB.

4 FEB. 63

A corp. is not jointly liable for the acts of the individuals of the corp. per an old N.Y. case. But, this is not the law today re joint liability. For the acts of the corp., the corp. is severally liable from the liab. of the actor; and if agency is shown, the corp. can be jointly liable, too. IP See Mechem on Partnerships.

① Limited Partnership Act - designed to overcome the question of ltd. liab. Provides that ∃ must be at least one gen. ptnr., but ∃ can be any no. of SPECIAL ptnrs. The special ptnrs. are listed but don't run the ptnrship., and are liable only to the extent of their contribution to the Pₚ. The GEN. PTNR. would have unltd. liab. If the special ptnr. participated too much, he could become a gen. ptnr.

② MASS. TRUST - another attempt to get around ltd. liab. e.g. A, B and C would convey their prop. to T who would run the biz for the benefit of A, B and C. So, at most they only stood to lose what they'd conveyed to T: the extent of their contribution. IP After initially upholding this trust, the Mass. cts. then began eating away at it: if the cestui que trust (A, B & C) exercised control over T, then it would be a Pₚ. The fault in this reasoning is that ∃ had been a conveyance, and under the law of titles ∃ must be a reconveyance

of the prop. or an abandonment or A/P.

Q. Could T indemnify himself from the trust funds? = Scott says: yes, if the T had so agreed at the time of raising the trust. Bogert says: yes, as of right as a matter of implication from the nature of the arrangement.

(3) Joint Stock Company — arose due to difficulties of Mass. Trust. Said to be a glorified ptnrshp. but differed because the stock was assignable and that gave it longevity. Big drawback: it was not a legal entity in and of itself, and had unlted liab. like a Pt.

Doctrine of Selectis Personam — see this. Statutes have now lessened the effect of this.

* (4) Corporation — a separate, legal entity and, in this way, differs from the other devices.

Corp. goes as far back as the 2nd Book of Justinian and the PECULIAM. Bracton, a C.L. lawyer, expert in Roman law, said the corp. could not exist w/o official sanction of the State, and the corp. needed the seal of the State. IP thus came famous case of * Woodward v. Dartmouth: "a corp. is an artificial person existing only in the contemplation of law w/ its main attributes being immortality and in-

dividuality." So, a corp. would be separate and distinct from its founders and directors.

The Slaughterhouse Cases held that the 14TH Amend. did not apply to corps. The Santa Clara cases said it did.

6 FEB. 63

Between shareholders (S/H) and the corp. there is what is called the CORPORATE VEIL. Since corps. were created under the State laws, it was thought that the corp. was an arm of the State. Today, nearly every State has a corporate enabling act (G.S. 55 - T.I.). Now, this is purely a statutory matter, and method of incorp. must be in compliance w/ the statutory requirements. (See mimeographed material.)

Since the Santa Clara cases corps. have gotten the mobility and fed. protection from State restrictions under the 14TH Amend.

"Qualifying Statutes" are found in all of the states. They provide that to do biz, the artificial person must qualify. This was a reasonable distinction between natural and artificial persons and is an allowable discrimination, therefore, under Constitutional Law.

Under the corp. veil, the individuals

are protected from unltd. liability, and are liable only to the extent of contribution.

Taxation on the corp. per se is another advantage of corps. But, it could be a disadvantage in that profits are taxed to the corp., and dividends, paid out of earnings (profits) are taxed to the S/H as income tax. So, that would be permissible double taxation.

Caveat: If the corp. veil is pierced, court will look at the whole operation as a Pt more or less.

One way to avoid the double taxation will be on a big S/H votes himself onto the Board of Directors and votes himself a huge salary. Then, the corp. would deduct that salary as an ord. biz expense, leaving the S/H – director to pay his own tax. But, here the Ct. may pierce the corp. veil and see this manipulation as merely a distribution of dividends, and still tax twice. This is most often found in closely held corps.

Ass
of
Not

Assignment – Chap. I (Mechanics of incorporation)

PROMOTERS

NOT REALLY A K; MORE LIKE ARTICLES

7 FEB. 63

Q. What is the liability of the promoters of the formation of the corp.?

After the incorp. agreement is drawn, the first meeting of the board of directors is held and the "K" of incorporation (the articles, i.e.) are adopted. Then, there must be an issue of stock.

*

Promoter Liability – *

There is no P-A rel. until the corp. is formed.

* Three theories re corp. liab.-

(1.) The corp. is not liable until the corp. either:

(a.) adopts promoter K,

(b.) works a novation ~~by~~ by substitution of corp for promoters, or

(c.) Ratifies the K.

(2.) where the corp., when it comes into existence, merely adopts the K, the third party can elect to go against the promoter or the corp. because the adoption merely adds the corp. as a party to the K. To avoid this now, the K will provide that when the corp. is formed, there would be a novation and not merely adoption.

(3.) Quaere liab. of promoter to S/H.? There are three maine cases in this area (know these).

Old Dom. v. Lewissohn,
210 U.S. 206, 28 S. Ct. 634,
52 L. Ed. 1025 (1908).

Old Dom. etc. v. Bigelow,
203 Mass. 159, 89 N.E. 193,
40 L.R.A., N.S., 314 (1909),
aff'd. 225 U.S. 111, 32 S. Ct.
641, 56 L. Ed. 1009; Ann. Cas.
1913E, 875.

Old Dominion Copper Mining Cases — two promoters gave the corp. highly over-valued land in return for stock equal to the over-value. Then, the stock was turned back into the corp. and it (stock) was sold on the open market. Therefore, the corp. had insuff assets to back up the stock. The buyers on the open market paid full value. Then, the s/h sued Bigelow in Mass. and Lewissohn in N.Y. fed. ct. for secret profits. The Mining Co. and Bigelow were Mass. citizens, and Lewissohn was N.Y. citizen. The Mass. case said the promoters were liable. The N.Y. fed. case reached the Sup. Ct. of U.S. and Holmes, Ch. J. said that the corp. was liable due to adoption of the K of incorp. and the promoters were not. Some writers say that the split was due to lifelong rivalry between Rugg, Ch. J. of Mass. Sup. Jud. Ct., and Holmes.

"The corp. died aborning."

The majority of states have adopted the Rugg view, but the fed. view is still the Holmes view w/ the Cardozo exception under the Duquesne Power & Light Co. case (the valuation was so greatly over-valued that the corp. was insolvent at birth and the promoters would be liable therefore).

The Rugg view holds that the promoters were liable because the

"Totality of Transaction" View (Rugg)

total transaction must be looked at; that where the "wrong" was done before incorp. but the injury did not occur until after incorp., the ct. must still look back beyond the time of incorp.

The Holmes view holds that the ct. cannot pierce the corp. veil and go beyond the time of incorp., and that, therefore, the corp. — not the promoters — would be liable.

* DOCTRINE OF EQUITABLE CONTRIBUTION - all stock is made equal except on K makes it unequal. This is really the basis of Rugg's view of the continuing liab. of the promoter to S/H (inside third parties).

11 Feb. 63

This doctrine means that among the S/H, each must contribute equitably to the corp. So, the drafting lawyer of the articles and the agreement to incorp. should provide that all shares should be sold for not less than par. If a S/H got shares for less than par, then that S/H would not have equitably contributed to the corp. e.g., there are 2000 shares at $10 par each = $20,000 capital stock. So, on the corp. receives less capital value than the capital stock, it has been

e.g., A, B, C + D each contribute $4000.00, and E gives prop. worth only $3900.00 but gets $4000.00 worth of the issue. So, there is "watered stock" to the extent of $100.00 because E has not contributed equitably.

an injury to the corp. So, the other S/H would complain derivatively in order that the corp. would benefit.

Theoretically, the capital stock = trust fund for creditors.

Regardless of the class of the S/H (common or preferred), y must still be equitable contribution. [We're talking about a paid-up issue of stock, not a credit transaction.] But see "G.S. 55-50 (2)" regardless of any impairment of stated capital." This has not been construed. But, usually impairment of capital stock will limit the corp., e.g. declaration of dividends would not be allowed as long as y is an impaired capital stock.

This might arise on a creditor of the corp. feels that his security has been impaired because E (the inequitable S/H) has not contributed equitably.

Assign. - Chap. 2. Defective Corps.

Piercing the Corporate Veil

When a court finds that it should pierce the corp. veil, it is saying that y is NO corp., and the contributors should be treated as mere partners.

13 Feb. 63

Chap. II.

THE DE FACTO DOCTRINE

DEFECTIVE CORPORATIONS: DE FACTO DOCTRINE

A corp. only exists w/in the contemplation of the law. Thus, y should be complete compliance w/ the law. Thus is so even though the corp. was formed under private acts of the legislature

DE FACTO CORPS. – developed due to the idea that even upon a defect, y should be something between a de jure corp. and a finding of partnership.

Requirements for De Facto Corporations

Three factors:

(1.) Was y a ~~valid~~ law, under wh the "corp." was organized?

(2.) Was y colorable compliance w/ that law?

(3.) Was y corporate user, i.e., did it act as a corp.

Effect of De Facto

If all three were found, the parties would not be treated as partners but as a corp. as if formed de jure. Not attackable collaterally, but only by direct attack by the State and usually by an action quo warranto. See Pocahontas Coal Co, 174/245 – the real distinction between corps. de facto and de jure is that the latter only could resist an action quo warranto by the State. As to third parties, y would be no difference and they would have to seek relief from the corp., not the individuals.

Quo Warranto

De Jure v. De Facto

Colorable Compliance: Quaere: Big issue: what = "colorable compliance"? = Courts have split here. e.g., Suppose the incorp. papers are filed in ~~only~~ one of the two required State offices. Since a corp. exists only by the grace of the law, would non-compliance strictly bar defense by corp. officers, etc., that they are not liable because the corp. is liable?

(1.) One view - filing in either of the two places = colorable compliance.

(2.) 215 I65?, Hammond v. Wms - N.C. implies that the de facto problem still exists; that the facts must be looked at to deter whether the corp was doing biz from the time of alleged incorp., because although the filing of the articles may create the corp., whether the corp. was doing biz is another question; that, however, the state could still institute an action quo warranto. This last provision of the statute seems to preserve de facto corp. concept by preserving the quo warranto test of de facto corps: the state could directly attack, but it could be no collateral attacks by third persons.

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The articles must be filed w/ the Secy of State and at the place of biz. (N.C.G.S. 55-8) Three steps of incorp.:

1. Draft articles.
2. File articles w/ Secy. of State
3. " " at Principal place of biz w/ the clerk.

(3.) Third viola - no filing of the articles at all would still give rise to de facto corp. (other factors being equal); a fortiori, filing in only one place = colorable compliance. Baker v. Bates-Street Shirt Co. 6 F.2d 854 - see this. Lattin feels the result is correct, but y in some dispute.

(4.) That because the "corp." has held itself out as a corp., a doctrine of loose estoppel would apply (doesn't require as much reliance to one's detriment).

G.S. 55-9 - debts cannot be incurred until the minimum capital is on hand. See this.

Read Lowell Hardware case.

14 Feb 63 ♡

DOCTRINE OF ADEQUATE CONTRIBUTION -

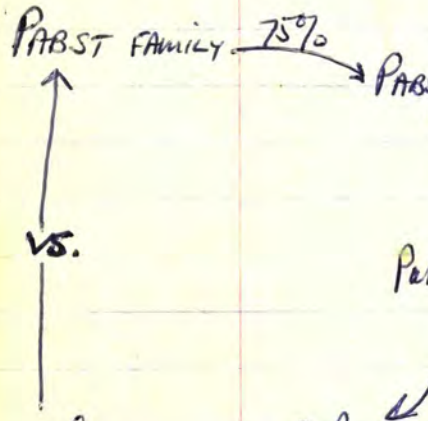
Cardozo in Berkley v. 3rd Ave. Ry. Case - Corp. A, w/ adequate capital, set up Corp. B w/ inadequate capital. A owned all of B's capital. 3rd party wanted to sue A, though injured by B. Was the capital of B adequate to prevent the court

6 F.2d 854 at 856 - "... y was no colorable compliance w/ some of the essential stat. requirements, such as recording the certificate in the registry of deeds and filing a copy w/ the secy. of state and paying the filing fee, for the appellants, thru their atty., failed to do these things. Thus, the effect was that those who acted for the "corp." were acting w/o authority since y was no principal and, consequently, were principals themselves.

from looking back to corp. A by piercing the corp. veil of B and finding A liable to third parties? — This doctrine was brig. applied in subsidiary corp. cases. But, Cardozo found that corp. B (1st Ave. Ry) did have adequate capital for the purposes for which it was organized. So, the doctrine was dictum in the Berkeley v. 3rd Ave Case.

This really came up in the Pabst case — a crim. case by U.S. Govt. v. Pabst family for allegedly accepting an illegal rebate. Pabst family owned 75% of the stock of Pabst Brewing Co. which, in turn, owned the Pabst Transit Co. which had negotiated w/ the R.R. The Transit Co. had $250,000 but did $10 million biz per year. The Sup. Ct. held the family would not be liable, but that the corp. veil of the Transit Co. could be pierced under the reasoning of Cardozo's "Doctrine of Adequate Contribution" and the Pabst Brewing Co. could be held liable. — 7 Minn. L.R. 79 (Ballantine on Adequate Contribution). Quaere on the line between "adequate" and "inadequate" can be drawn.

Today, only is inadequate contribution, the corp. veil will be



pierced and the individuals will be treated as mere partners. So, nowadays this doctrine will apply, or should apply, to non-subsidiary corps. situations, too

Many facts must be considered. e.g., interlocking directorates (same Bd. of Directors in mother and daughter corps.).

Some cts. say "inadequate" means anything less than the declared cap't. Some say that "inadequate" means nothing. Under the latter view, if $1 is some contribution, it is adequate. Some courts say that even $1 is inadequate capital, there would still be a de facto corp. nob would not allow the veil to be pierced. See 128 A.L.R. 878 for collection of cases.

* 128 A.L.R. 878

* CORP. BY ESTOPPEL *

Thus says a corp. can be found even though there was no corp. in reality. This requires that the "corp." have acted like a corp., held itself out as a corp. and have been relied on by the third party to its (3rd party) detriment. N.C. says: no stock is necessary, no meeting of directors is required

78 N.C. 57
99/507

either, and that could still be considered a corp. by estoppel.

18 Feb. 63

CHAP. III PRE-INCORP. TRANSACTIONS BY PROMOTERS

NOVATION

It is gen. considered that a novation is worked when the corp. is perfected, but that is usually so only when y is a clause so providing in the articles.

RATIFICATION

Ratification presupposes a person who could have acted, and that is not so because the corp. did not exist until incorp. was complete. e.g., O'Rorke v. Geary, (p. 74.) Some cts. talk in terms of ratification but should really talk of estoppel.

ADOPTION

Under adoption, the promoter would also be liable, but they would be severally liable.

(b) Liability of the Promoter

O'Rourke v. Geary (p. 74)

At the time of transaction, did O'R. intend to deal only w/ Geary, or by hindsight are we giving O'R. a new channel of recovery? It would seem that then O'R. was intending to deal w/ the Bridge Co. to be incorporated. There was no intent to deal w/ Geary really. But, the ct. said that he had intended to deal w/

Geary. - G was even a clause exculpating himself from indiv. liability. IP See R.A.C. v. W.O.O.F., 52 S.E. 2d 617 - Capitol Theatre in Atlanta on Peachtree Street. The D argued the opposite of ~~the~~ O'R. v. Geary, saying that it had intended to K only w/ the corp., not w/ Volce as an indiv. - promoter. Ga. Ct. agreed and held for D. IP See 17 A.L.R. 431 and at 452 (2 parts); Sec. 21 of Fletcher's Encyclopedia of Corps., 11 Minn. L.R. 465; 38 Yale L.R. 1011; Weeks v. San Angelo, 65 S.W. 2d 348. So, this is a question of intent, and cts. should apply the objective test.

TEST

Suppose the members of the association refuse to adopt the agreement, would then the promoter be liable?

The Ga. Ct., supra, went to the theory of "continuing offer", but might have talked of ratification if the P had been a Georgian and not a Yankee from N.Y. Ga. has talked of novation and ratification many times before.

Kansas has a stat. w/ legislatively recog. novation. see p. 88.

Go to Chap. IV.

20 Feb. 63

Chap. IV Control and Management

Under the majority of statutes, the management of the corp. is in the Board of Directors. It is thought that y is a fiduciary duty, running lineally (vertically) from the Directors to the shareholders.

Q. Suppose a conflict between the Directors and the shareholders? = If S/H are unanimous, J/S/H.

G.S. 55-24 - a little liberal. This statute, like most of the state statutes, says that the management and control of the corp. are in the Board of Directors. But, if the S/H unanimously agree to something contra to the Directors (hereinafter B/D), the B/D may be bound to follow the S/H.

Classification of Directors

In an attempt to control the B/D, S/H sometimes elect staggered B/D. N.C. allows staggered B/D only if are 9 or more Directors.

* Each S/H is entitled to the unfettered discretion of the B/D, so the mere majority of S/H cannot govern: only unanimous S/H action.

See Lattin, sec. 4 (p. 216)

Q. What's the effect of the B/D acting informally? = Only, cts. said

that ~~the~~ statutes pay the control and mgmt. of the corp. are vested in the B/D as A BOARD. Then 97 F. Supp. 295 (Pa.) came along and said that ~~we~~ admit the S/H are entitled to the unfettered discretion of the Directors based on conflicting opinions finally resolved, but it is not required that the B/D act only at Board meetings. i.e. Maybe agreement among the B/D over the telephone will suffice among close corps. To say otherwise, says Judge Gurley, would be to shackle unrealistically the B/D; that the Board has ostensible power to act on all of the Directors have acted even though informally. Gurley, J., resorted to agency law for support to find that it was ostensible authority to act informally as a Board. But, normally, directors are not agents of the S/H because they are not bound by the majority opinion of the majority of the principal, the S/H. — But, the majority of ~~the~~ us have picked up Gurley's exception to the general rule but the proviso that the informal action must be unanimous among the

Rule: Informal Action by B/D

42 N.E. 2d 273 (1942)

55-29 (a)

directors. See B&O RR. v. Foar, 84 F. Supp. 67; 42 N.E. 2d 273 (1942). The Foar case seems to engraft an exception to the majority's exception to Gurley's exception. See 42 N.E. 2d 273 re the majority's exception (proviso) to Gurley's exception.

See 55-29 (a) for N.C.'s position.

21 Feb. 63

55-29 (a) - action by majority of B/D (informally) will be deemed "Board action" (w/ a proviso). See 34 N.C.L.R. 432; Park Terrace Co. v. Phenix Indemnity Co., 243 595 (1956) (Right after this case, Chap. 55 of the G.S. was passed). So, the Phenix case was legislated out of existence, because now it can be a one-man corp. after the corp. has been formed w/ at least three or more at the time of incorp. The act talks in terms of "NATURAL persons" setting up corps., so it seems to imply that a corp. cannot set up another corp. So, a corp. would have to use subterfuge to set up another corp.

(Sec. 3.) ACTION BY OFFICERS

Officers are gen. appt'd. by the B/D, are answerable to the B/D, and cannot have any powers in excess of the directors. They owe a double fiduciary duty: to the S/H and to the B/D. The officers are in fact agents of the directors. G.S. 55-35 & 36: has not been construed yet, but raises this question, to wit: does the "ordinarily prudent man" mean the O.P.M. in a big sense guilty of culpable negl. in a bus. sense" or in the meaning of the Cardozo test? B/D and (NOTE: it is gen. illegal for Officers to declare, and for S/H to receive, an unlawful corporate distribution.)

(NOTE: a balance sheet is valid and reliable only to the day it is made up.)

G.S. 55-36 - gives specific powers ~~and duties~~ to certain officers, certain ostensible powers to the pres. and secy. "unless it shows on its face a potential br/ fiduciary duty." So, the lack of authorization would not be a defense available to a third party.

On an officer is also a director, he is a principal and agent: principal when acting for himself, agent when acting for the others. Like a ptnr.

missed next two lectures: sick.

25 FEBRUARY 63

(Hill's notes)

Role of Shareholders

(1.) Theoretically, S/H are the owners of corp.
  (a.) Money is life blood.
  (b.) They elect B/D which elects officers.
(2.) Voting rights now vested in shares.
(3.) Have preference in dividends or liquidation in lieu of right to vote given to some.
(4.) Problem how will shares vote?
  (a.) Should not each share vote for a director?
    (1.) Cumulative voting

100 shares; 9 B/D; so entitled to 900 votes.

(N.Y.) Art. 6, Bus. Corp. Law 618 - no mandatory requirement.
G.S. 55-67(c) ← mand. requirement of announcement of cumulative voting. G.S. 55-26 Staggered Board.

Problem: Express provisions in charter should knock out prov. for cumulative voting.

If in soliciting proxies
N.Y. ← (S 609), cumulative voting gives party tremendous powrr.

NO. of shares X no. of dirs. = cum. voting power

Mason - ownership and control have now been separated. By (609, 618) mgmt. now controls.

Corp. in Modern Society – Mason
p. 46 – discusses control by mgt.

Proxy Expenses

B Fidcorp. expense: proxy fight. Here, this is taken from assets that would ord. go to dividends.

Construe cumulative voting and proxy fight together because debt is usually the problem.
See p. 203 Williams.

Example in Book

$$X = \frac{900 \times 1}{8+1} + 1 \quad (p.203)$$

$$X = \frac{900}{9} = 100 + 1 = 101$$

N.Y. – 618 – Cumulative voting strictly a drafting problem. If included in Articles, cumulative voting is possible.

Purpose – give minority some power in electing B/D.

(p. 195) – Ill. gives right of cum. voting by Const. and statut.
126 N.E. 2d 701 – WOLFSON v. AVERY – Declassifying the B/D is diluting. Staggering the B/D + w/ cum. voting, the minority will never have

One of the purposes of a staggered B/D is the continuity of policy; you'll never have all leaving or being voted out at the same time.

power. The staggering of B/D effectively dilutes the right of cumulative voting. Court agrees.

Janney v. Phila. Trans. Co. (p196)
Contra. to Wolfson case.
* Three theories on minority S/H voting rights:
(1.) Staggering dilutes right of cum. voting.
(2.) Janney – no inconsistency between staggering + cumulative voting.
(3.) Humphreys – Sup. Ct. of Ohio followed Janney on reversal: No inconsistency. You still have the guarantee but not have effectiveness. – Ohio has no Const. on Corps. but it's done by statute (133 N.E. 2d 784).

N.Y. followed Ohio's 1955 revision on staggering – minimum of three in a class (204 N.C.L.).
Classes defined in N.C. Staggered board not possible w/o 9 man board. – Not in N.Y. – N.C. seems to have protected the small B/D.

B.C.L. 702 - check last clause.

Cal. + Ala. = only states w/ stats. prohibiting classification staggering.

Staggering probably arose by accident.

Problem: if we stagger Bd, have cum. voting and directors who can solicit proxies, is this not perpetuating the B/D?? = YES.

Proxies ltd. irrevocably to 3 yrs. in N.Y. Para. 6 - comment says it is better for S/H.

N.C. limits it to 10 years.

(c) PROXY CONTROL (p. 207)

Proxy Expenses

If insurgents are successful, loss of proxy contest = a corp. expense.

Q. Problem — suppose insurgents are not successful, should not the corp. pay expenses since the S/H have received benefit of info from contest? =

28 Feb. 63

LABOR LAW — 1961 Amend. to F.L.S.A. – to cover ~~exec~~ who receive commissions in retail & service establishments.

*(3.) Proxy Contest Expenses *

(p. 227) Rosenfeld v. Fairchild Engine & Airplane Corp.
The insurgents were successful, and could be compensated for their expenses in the proxy fight.
The test is whether the expenses were reasonable to test the company policies.

*(Sec. 6) Special Problems of the Close Corp.: Organization and Operation of the Firm to Achieve Partnership Advantages *

(p. 241) Ringling v. Ringling Bros. – Barnum & Bailey

VOTING TRUSTS

There was an agreement that one would not sell any stock to anyone other than the three (3) agreeing parties w/o first offering to sell to one of the three.
This was not a voting trust because the arbitrator was not invested w/ the voting power separate from the stock ownership itself.
⊛ Proxy v. voting trust? The V.T. may be voted any way the trustee sees fit, but the proxy must

go the way the S/H says it must go. Courts are split (as the two Ringling cases show) re whether deadlock-breaking agreements will be enforced.

4 MARCH 63

Abercrombie v. Davies (p. 256)

Ct. found that the mutual promises supported the Agents Agreement; that this was not a voting trust because the voting power was not divorced from the ownership of the shares; that this was a valid pooling arrangement because the proxies were supported by and "coupled with an interest" and, therefore, were irrevocable for the agreed 10 years. Thus, all parties to the agreement were bound by the pooling agreement during the 10 yrs.

The Ct. talked about reliance of the other parties to the Agents' Agreement on each and every party thereto; thus Ashland was bound to follow suit. Reliance was the basis of the decision, and the "interest" (w/ wh proxies must be coupled to be irrevocable) arose out of this reliance. The "agents"

Pooling Agreements

had an interest in the independence of American Indep. Oil Co.

The ct. said (or implied) that there was no P-A rel. here, but this was really a shareholders' agreement.

G.S. 55-73
55-71

N. Carolina - very broad stat. See 227/226; In Re Hotel Raliegh, 207/521; 34 N.C.L.R. 432. The statute provides that if any dispute arises, the ct. can simply declare the result of the election, and the irrevocable proxy would not even be necessary. G.S. 55-73(b): Says that the buyer of shares coupled w/ voting obligations takes the shares AND the voting obligations!!

(b.) Agreements Affecting Action By Directors

See G.S. 55-73(c).

Assignment: McQuade + Clark cases.

Allen, goto pl. 350 - Ultra Vires.

Read p. 276 to p. 350 on your own. Responsible for it.

6 MARCH 63

McQuade v. Stoneham & McGraw (p. 262) – held, "... that a K is illegal and void so far as it ~~breaches~~ precludes the Board of Directors, at the risk of incurring legal liability, from changing officers, salaries or policies or retaining individuals in office, except by consent of the contracting parties."

* It is against public policy that S/Hs, by agreement among themselves, control the directors in the exercise of the judgment vested in them by virtue of their office to elect officers and fix salaries * Their motives may not be questioned so long as their acts are legal. The bad faith or improper motives of the parties does not change this rule * Directors may not, by agreement entered into by S/Hs, abrogate their independent judgment.

S/Hs may, of course, combine to elect directors. But the power to unite is ltd., however, to the election of directors and is not extended to Ks whereby limitations are placed on the power of directors to manage the biz of the corp. by the selection of agents at defined salaries.

Manson v. Curtis (p. 265)

Dictum here seems to say that if S/Hs unanimously agree among themselves, they may do as they choose w/ the corporate concerns and assets, provided the interests of creditors are not affected, because they are the complete owners of the corp. — This is diametrically opposed to the McGhadt holding. So, there seems to be some confusion. But, the dictum here does violence to the concept of a distinct corporate entity. However, the dictum is inapplicable because it was not universal agreement among the [redacted] S/Hs.

p. 55 - 32
55 - 54

These two cases say that the agreements could not be upheld because it were innocent parties (S/Hs) who were not parties to the agreement.

Clark v. Dodge (p. 265)

This was purely internal. Ct. sought to distinguish this case from McGlade by saying that it was no danger

to the S/Hs because all of them were directors and they did not stand to be harmed.
See Seaboard Airlines Case, 240/495, 82 S.E.2d 771 (came up just before N.C. corp. statute was amended). 68 Harv. L.R. 541 - criticizes this case.
These agreements may get even more trouble (135 U.S. 504, West v. Camden; 200 N.E. 111 [Mass.], Mansfield v.) on the promotional level.

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7 MARCH 63

(CHAP. 4) - (SEC. 8) * DECLINING ROLE OF ULTRA VIRES *

"beyond the powers" = ultra vires.

Gen. Rule

G.S. 55-17 - stat. in N.C.
The purpose clause of the Articles of Incorp. governs. Any corp. activities in excess of the stated purposes will make the corp. ultra vires, and, i., the corp. no longer would exist w/in the contemplation of the law.
There are implied powers (e.g., building homes for Exec - Steinman Case), but once that is exceeded, the corp. is operating "beyond its powers."
Leading English case: Ashbury Ry. Carriage Co. v. Rich, L.R.; 7 H.L. 653 — (note on p. 354) the question is one of the power of the corp. to

even make the K. A corp. can only exist in the contemplation of the law, and the law did not give this co. the power to build a railroad.

In drafting, make your purpose clause as broad as possible. Some states (Ohio) have a gen. purpose clause by statute: "all the powers of a natural person."

* Ultra virus is found in two broad areas:

(1.) Rels. between the corp. and third parties. This is the area ok the doctrine is declining.

(2.) Rels. between the corp. and S/Hs. U/V is growing issue in this area.

In area #1, it is often inequitable to invoke u/v. N.C. G.S. 55-18(a) has eliminated the defense of u/v as against third parties.

See Brinson v. The Co., 219 N.C. 499, 14 S.E. 2d 505, 219 N.C. 505, 114 S.E. 2d 509 (two cases under the same name) — very important case.

But Ohio does allow u/v in area #2, below.

55-18(a) - Removed defense of u/v.

Gen. Rule: A director who dissents from proposed actions of the corp.

Majority of States (ca. 31) apply "ultra vires" only to inter-corp. actions (e.g., S/H v. B/D) or any matters w/in the corp. But, as to third parties outside the corp., ultra vires is almost dead. ← N.C. 1900

will not usually be liable on the corp. acts ultra vires. But, we hold strongly you must dissent and whether it must be a matter of record, etc., is not certain. This is in point w/ the Wood Mill Case. See also 148/107; 149/65.

Gen. Rule [On the corp. acts ultra vires, the directors would be personally liable.

A.P. Smith Co. v. Barlow, 98 A.2d 581 - famous case. B/D gave big sum to Princeton U. (They were alumnae of Princeton), and the S/H objected. The Ct. held that this was w/in the implied powers of the corp.; that the gift was to an established eleemosinary institution (but dictum stated*

* that if the gift had been to merely a "pet charity" of the B/D, it would have been struck down.

11 MARCH 63

(Chap. V) LIAB. FOR CORP. OBLIGATIONS: DISREGARD OF THE CORPORATE FICTION (OR, "PIERCING THE CORP. VEIL")

Automotriz Del Golfo etc. v. Resnick, 306 P.2d 1 (1957, Calif.) - Gen., conds. under wh. a corp. entity may be disregarded vary per circumstances of each case, but two (2) requirements for disregard of the corp. entity are that y he such unity of interest and ownership that the separate personalities of the corp. + the indiv. no longer exist and that, if the acts are treated as those of the corp. alone, an inequitable result will follow.

Two broad problems:

(1.) Disregard of corp. entity only is one corp. only + doe want to reach the indiv. to stick him w/ liability. Usually arises only is a thinly capitalized corp ("thinly veiled"). Two approaches:

(a) Deep Rock Doctrine - arose out

37 Failure to issue stock or to apply at any time for a permit is an indication, although not conclusive evid., that persons purportedly doing biz thru a corp. are doing biz as individuals. P a factor to be considered in determining whether individuals dealing thru a corp. should be held indiv. responsible for the corp. obligations is whether it was an attempt to provide adequate capitalization for the corp. P In deter. whether Ds should be allowed to escape personal liability for debts due P, on grounds that Ds were operating thru corp; the trial ct. was entitled to consider all of the foregoing factors and (Berry v. Old South, etc.) all the relevant facts re the manner in wh the biz was operated.

of the Deep Rock case. This subordinates the credit claims of S/H in favor of bona fide creditors. Here, the corp. can meet the bona fide debts w/o paying the "creditor S/H."

(b) Old South Engraving Co. Case - 186 N.E. 601 - a labor dispute here. Mass. ct. refused to pierce the corp. veil here on the basis of unclean hands, but set up two propositions:

1. The identity of D/D + S/H of the new Co. w/ the old co. will not merge them nor make one the agent of the other. (D-here = old co.) 32 Mich L.R. 551 severely criticizes this case; also 18 Minn. L.R. 597;

2. If there is identity of S/H, D/D, etc., wh bespeaks fraud, the corp. veil will be pierced. See also 24 F.2d 378, Green v. Victor Talking Machine Co., cert. denied, 278 U.S. 602.

DERIVATIVE RIGHTS OF S/H

278 U.S. 602

S/H rights, as far as injury to the corp. is concerned, are derivative. Also spoke of

piercing the corp. veil because the s/h had only derivative rights.

BASES FOR "PIERCING THE VEIL"

Berkey v. Third Ave. Ry. Co. (p. 369) Control and dominion (of parent corp. over subsidiary) fraud and misrepresentation are the touchstones of piercing the corp. veil.

Weisser v. Mursam Shoe Corp. (p. 376) D was so completely controlled by another, and so completely inadequately capitalized that the court pierced the corp. veil.

See Resnick, 306 P. 2d 1 (1957) - best stmt. of "piercing the corp. veil." (See p. 31, supra)

See Abbott v. Anderson, 321 U.S. 349; Barber v. Thompson, 7 F. Supp. 271 - The fact situations are almost identical. Found necessary to pierce the corp. veil because the corp. was not adequately capitalized (or not at all), and these several facts combined for a finding of fraud. This was an attempt to get the benefits of incorp. w/o accepting the responsibilities.

72 F. Supp. 591 - Calif. Zinc Co. v. U.S.

? Park Poultry Corp.

21 N.E. 2d 687 - union tried to force family members who owned the corp. & did the work, to join the union. The family said, "we're Eers" (per K re "Ees"), and ∴ don't have to join. 4 to 3 decision. Held, the corp. veil would not be pierced & the family would have to go in the union if the corp. hired them, etc., and this family could collect workmen's comp. — Best stmt. is the dissent: "when (such & such) are formed it will be treated as an association of persons"

A s/H is a creditor of the corp.

And see Calif. Zinc Co. v. U.S., 72 F. Supp. 591 - can we say that Zinc, The Ry. + Glidden Paint were one enterprise + ∴ jointly liable (i.e., pierce the corp. veil of one or two or three of them)?

13 MARCH 63

(Chap. VI) DUTIES ~~OF AND~~ DIRECTORS AND CONTROLLING S/H

(G.S. 55-32) BALLANTINE §62, et seq.

*(SEC. 1)

As to management, directors owe a threefold duty to the corp.:

(1.) Obedience (to keep w/in the powers of the corp. as well as w/in those of the board).
(2.) Diligence (to exercise reas. care and prudence).
(3.) Undivided loyalty.

Re the standard of care, cts. are not in accord w/ their language. Some say that any director, even of banks, is liable only for "gross negl." N.Y. says a dir. must use "the care and diligence wh an ord. prudent man would exercise in the management of his own affairs." — The just rule (Ballantine) is that the directors undertake to use such care + diligence and give such time + attention as ordinarily careful + prudent men could reas.

DUTY OF CARE *

Briggs v. Spaulding was one of the first cases to say that directors have a duty of care: they must have "good sense."

Suppose a dir. just makes stupid judgments. Can he be held liable?

Hun v. Cary, 82 N.Y. 65 (1880) — the directors' act of building a new bank was so improvident that it constituted actionable negligence. — A starting point in this area.

Quaere the director's acts necessary to breach the duty?

Barnes v. Andrews (p. 402)
Hand, D.J. — director attended only one of two called B/D meetings + relied on casual

be expected to exer. on behalf of such a corp. under similar circumstances. What is a failure to exer. reas. care and diligence is always to be determined w/ reference to the circumstances of the particular corp., and to some extent of the particular director. The cts. have gen. held that the residence of a dir. in another state or at a great distance from the office of a corp., and the inconveniences of travel, cannot be considered as an excuse for non-attendance at its meetings or inattention to its affairs.

Reliance on Counsel

§63a. Although directors are commonly said to be responsible both for reas. care and also for prudence, the formulas is continually repeated that directors are not liable for losses due to imprudence or honest errors of judgment. ....

Bates v. Dresser

Cts. will not, in gen, undertake to review the expediency of Ks or other biz transactions authorized by the directors. A large discretion is lodged in them. Questions of value & policy are for their biz judg., & tho' their errors may be so gross as to show their unfitness to manage corporate affairs. But it is presupposed in this "biz. judg. rule" that reas. diligence & care have been exercised.

Some cts. deny that a dir. gives any implied warr. that his judg. is good or that he has any fitness for the position. Directors remarks of the corp. Pres. as to how business was going. Q will general MISPRISON (inaction) make for liability? = Hand said, "Directors are not specialists, like doctors or lawyers".

Quaere: Suppose the Director relies on advice of counsel? On the result was stupid? On the act was ultra vires? Cts are split. In ultra vires, no defense. On the decision is merely improvident & y was reliance on counsel, no liability; the defense would be good.

Bates v. Dresser (p. 395)

Banks are usually held to a higher standard of care than other corp.

"Vicious dog" Rule (Coke at C.L. - "every dog is entitled to at least one bite): the first mistake is free. But, thereafter, the party is put on notice. Y was nothing to put the D on notice because this was a new and novel way of stealing. But, having once been put on inquiry, any following misprison = liability.

Allied Freightways v. Cholfin (p. 408)

There was some language here like the "vicious dog doctrine."

36 of savings firms (banks), trust cos.; life ins. cos. and cos. which solicit the handling and investment of the funds of others, are by some ctrs. declared responsible for a higher degree of wisdom, prudence and good judg. than directors in ord. biz corps. It is doubtful, however, whether more is actually required than giving reasonable attention to the biz, making proper inquiries upon the matter in hand, and exercising an honest judg. upon the information available, unless improvidence goes to the point of wilful or negl. waste.

This case comes 30 years after Bates case.

It is generally agreed is a du/care owed by directors, but the question is what = br/du/care. Hand sets out the proximate cause theory, and Holmes (Bates case) talks of the "vicious dog" theory. So, it may be academic (liability of directors) except on the act of the director, or his inaction, is ULTRA VIRES.

Re 102 Tax Lon "hoarded" profits) 60 Harv. L.R. 1282; 61 Harv. L.R. 1058

What about interlocking directorates? Assign. - Duty of loyalty.

14 MARCH 63

* (Sec. 2) DUTY OF LOYALTY *

"A man cannot serve two masters."

Two problems:

(1.) Dir. deals w/ his corp. w/ his own prop.

(2.) Dir. deals w/ corp. w/ its prop. & using his corp. knowledge therefor.

Hypo: B/D agrees to buy land for expansion. Suppose Director A has such land left him by his Grandpappy, the land then being worth $2,000.00. Assume A will sell for $12,000.00. Assume that A's vote is necessary to carry the K because of a split between the other directors. The dissenting directors say that A is serving two masters. Can they have the K set aside after purchase?

Hypo: Same, but A does not own the land but knows someone who does. A buys the option on the land & will sell to corp. for $12,000, and A's vote swings the balance of power. Can the K be set aside after purchase? If so, could corp. still retain title but repudiate the K on the ground that A's profits were wrongful?

Could the K be valid if A did in fact deal justly and fairly and at arms length, and derived a fair and justifiable profit?

Could we say that A could not give the corp. his unfettered discretion because of his vested interests?

Would it make a difference

It is generally agreed that the Burden of proving the fairness of the K is on him who would seek to uphold it. Contra: Meyer v. Fort Hill Engraving Co., 249 Mass. 302, 143 N.E. 915 (1924): B/P on him who asserts the K's unfairness.

Hill case 239/437 - before new act.

new act

G.S. 55-30 (b) - participation by interested director will not make the K void or voidable, PROVIDED that .... (puts B/P on the one maintaining the validity of the transaction to show the fairness of it and to show that it was arm's length dealing.)

The Hill case seems to have been codified by G.S. 55-30.

Ill. Corp. Code [closest to the model code] has been widely copied almost verbatim; e.g., N.C.

Assign. - Read rem. of Chap. 6. Then go on to Chap. 8.

See Regenstein v. J. Regenstein Co., 213 Ga. 157, 97 S.E. 2d 693 (1957).

MODERN APPROACH

that 5 out of 7 directors voted for the K? (i.e., a disinterested majority.)

Under the N.C. code, (55-30) if it is full disclosure by the interested director, and specific approval by a majority of the B/D, okay.

Suppose it is an interlocking directorate. Should we then worry about the necessity of a disinterested majority? = On the corps. conflict, must the "double director" quit one? =

18 MARCH 1963

The more modern approach is that unless the corp. can show ~~the~~ inherent unfairness of the K of its director in it, the K will not be set aside. It will not be presumed void or voidable.

↘ Everett v. Phillips (p. 444)

Lehman, C.J., seems to go too far. He implies that a director need not even have and exercise good sense. The dissent is the

BETTER RULE: better and more widely accepted view: either corp. of wh the director in question is an interlocking director, can avoid the K.

(b) EXECUTIVE COMPENSATION

There are three basic arguments v. interlocking director's compensation:

(1.) Executive compensation is self-dealing and violative of the duty of loyalty.

(2.) That it is really a gift, and neither the S/H nor the B/D has the power to make the gift and deprive the corp. of it.

(3.) That it is an evasion of taxes.

This comes from an old case wh purported that a director is not entitled to compensation at all anyway. Later, the question was whether the pay was excessive and [redacted] unreasonable; and if not reasonable, it would be self-dealing.

The tax comm'r takes the position that any unreas. pay = dragging OFF of corp. assets and not deductible by the corp. as an ord. and necessary business expense. i.e., It would be a corp. distribution + not a corp. expense.

It would be declarable by the indiv. director. So, the tax man would demand two checks; from the director and from the corp. If many corp. gimmicks have arisen to avoid this.

General Issue — The question is — what is "reasonable" compensation?

(1.) STOCK OPTION PLAN — one of the gimmicks. The director would be paid a small annual salary + be given an option to buy stock at less than par. Then, the dir. would sell the options at the market value + realize the profit. But, in 1945, the Tax Commiss. said that these options should be declared as either ord. income or capital gains, and that the bases of capital gains should be allocated. — So, the plan fell into disuse until the new tax code ("Eisenhower Code"), sec. 421. So, stock options have now come back into widespread use. (See note, p. 463.) sec. 421 (b) has been criticized because a close

421

Fogelson v. Am. Woolen Co. (p. 472) – Courts are properly reluctant to interfere w/ the biz judg. of corporate directors; they do so only if y has been so clear an abuse of discretion as to amt. to legal waste. RE PENSION PLANS, disparity between pensions of Pres. of corp. and other Eees, proximity of retirement time of Pres. to time of adoption of plan, necessity of plan as incentive, and amount (total and annual) of pension of Pres. are all factors that at least raise a triable issue as to whether y is a waste of corp. assets.

Rogers v. Hill

Kerbs v. Calif. Eastern Airways (p. 476) Re STOCK OPTION PLANS: the validity of a S.O.P. under wh selected personnel of a corp. may acquire a stock interest in the corp. depends directly upon the existence of:

(1.) Consideration (some benefit) to corp. and (2) the inclusion in the plan of conds, or the existence of circumstances wh may be expected to insure that the contemplated consideration will in fact pass to the corporation.

corp. may not have any market demand for its stock whereas the big corps. would.

(2.) Pension Plan – to pay the party in the future upon retirement.

Under new N.C. stat. – Fulton v. Dalbert, 255/183 – N.C. treated this type of K under the "adverse interests" statute (55-30) and must meet that test of fairness.

(p. 464) Amer. Tobacco Co. case. Re a percentage payment of money as a result of the peculiar by-laws of the corp.

Issue: Did the percentage bonuses have any rel. to the volue of services rendered? If not, they would be gifts, i.e., corp. waste. Ct held these were gifts. After much litigation, in 1956 the corp. reduced the percentages and set up a pension plan and hospital benefit plan (still used today).

20 MARCH 1963

(c) OBLIGATION OF MAJORITY S/H TO MINORITY

(a waste !!!)

Zahn v. Transamerica Corp. (p. 487)
This deals w/ participating stock, cumulative stock and redemption.

21 MARCH 63

"calling up" - part of concept of redemption. Two types of calls:
(1) On stock is not fully paid for. (Not here.)
(2) On redemption. If stock cert. allows stock to be redeemed at the option of the corp. (redeem = buy back), it is supposed to be redeemed out of surplus only (otherwise, it would be defrauding of creditors because the capitalization [considered a "trust fund" for creditors] would be reduced).

Capital = no. of shares X par value. If stock is sold for more than par, the surplus goes into a "paid-in-surplus" fund. - It can be a "no-par" stock, but it must be capitalized at something (called "stated capital").
IP No stat. minimum on capitalization, but it is on the amt. you must have on hand to start doing biz. They are not the same.
IP Bad tax consequences on "no-par" stock → trend now to "low-par" stock.

Under no-par stock, the difference between the par value (e.g. 1½¢ per at Piggly-Wiggly) + the market value = paid-in-surplus wh can be used by the corp. for working capital for ltd. purposes, e.g., taking up shortage in surpluses.

In Zahn case, when the Class A stock was redeemed out of the surplus, this left little for distribution to other Class A stock outstanding. Thus, only Class B stock remained to be satisfied out of the assets. So, Zahn, holder of outstanding Class A stock alleged br/ fiduciary duty and self-dealing because D owned all of Class B and that became the only stock capable of being satisfied out of the large assets of the corp. upon liquidation. Zahn also alleges that liquidation was not necessary. Zahn = minority S/H. D (Transamerica) = majority S/H who also controlled the corp. whose stock is in question, Axton-Fisher. P/P is now alleging that he should be able to participate in the assets above his preference because of the breach of duty of D.

Held, the majority S/Hs owe a duty of faith and loyalty to the minority S/Hs PROVIDED that the majority S/Hs are also directors. i.e., There is no horizontal duty purely, but y is a vertical duty of loyalty; and on the maj. S/H are also directors, y is a "quasi area" of duty to the minority S/Hs.

Conflict/Laws Question in Zahn Case →

p. 491 – "y is a radical diff. when a S/H is voting strictly as a S/H and when voting as a director; that when voting as a stockholder he may have the legal right to vote on a view of his own benefits and to rep. himself only; but that when he votes as a dir. he reps. all the S/H in the capacity of a T^ee for them + cannot use his office as a dir. for his personal benefit at the expense of the stockholders."

(See last para. on p. 491!)

⊗ Axton – Fisher = Ky. corp.
Transamerica = Dela. corp.
Br/duty sounds in tort. Under "conflict/laws (choice of laws) rules, a tort is deter. by the law of the place of happenning of the last tortious act giving rise to liability. So, the court held that Ky. law applied on the question of whether y had been a br/duty of loyalty. IP the question of extent of remedy was held to be deter. by Dela. law because the amt. of recovery goes to the question of remedy, and the law of the forum has authority over remedial (or, procedural) matters.

Note the "aliquot shares" holding (p. 494). Aliquot means that amount equally divisible w/o a remainder (e.g., 8 is an aliquot share of 16, but not of 18). Thus, the P here would not be entitled to any remainder (e.g., the 2 [diff. between 16 & 18]).

So, on the majority S/H also is director, they "cannot run roughshod" over the min. S/Hs.

25 March 63

Taking Advantage of the Corp. —
* Involves two problems:
(1.) Intercepting corp. opportunities.
(2.) Fleecing the corp. — e.g., buying up claims v. corp. & making profit.

#1 is the more troublesome area. Involved are duties of loyalty and disclosure. e.g., If a dir. did vote for acquisition of some prop. and this would mean an impairment of capital (ultra vires), can he refuse to vote for it, and then buy individually? If he does so, and realizes a profit, can he be compelled to turn over the profits on the ground of br/ duty / loyalty? =

Irving Trust Co. v. Deutsch, (p 510) said that [redacted] the corp. was in no position to take advantage of the opportunity, the directors could not indiv. intercept that opportunity, and that to do so would = a br/duty/loyalty and make the directors liable for an accounting. — The defense that the K was ultra vires Aconstic, and hence its directors and officers violated no fiduciary duty in taking stock wh the corp. could

Mfgrs. Trust Co. v. Becker, (p. 502)

Mfgrs. Trust Co., as Tee, under an indenture made by Calton Crescent, Inc., debtor, on 9-27-33, and individually as a creditor, objected to allowance of the claims of Regine Becker, Emily K. Becker & Walter A. Friburg as filed, on the ground that claimants were close relatives and office associate, respectively, of debtor's directors and that their claims should be ltd. to the cost, plus interest, of debentures at a large discount (3 to 14 per cent of face value). Objections overruled: (1.) Corp. assets are not trust prop. even when the corp. is insolvent, and corp. director who purchases claims v. corp. is not subject to rule that a Tee can make no profit from his trust. (2.) Equity should subject corp. fiduciaries not only to the doctrine of unjust enrichment but to a standard of loyalty that will prevent conflicts of interest. (3.) In deter. whether a dir. should be permitted to purchase claims v. an insolvent but going corp., the potentiality of conflict between self-interest & duty

"CORPORATE OPPORTUNITY DOCTRINE"

must be weighed v. the desirability of reinforcing the corp.'s financial cond. by such means.

Several Amer. cts. have held that the directors are in general free to buy for themselves if the owner refuses to sell to the corp., provided they do not instigate that refusal. 66 App. Div. 95, 72 N.Y.S. 701 (1901).

BALLANTINE, 204 (1946) – "The true basis of the doctrine should not be found in any expectancy or prop. interest concept, but in the unfairness on the particular facts of a fiduciary taking advantage of an opportunity when the interests of the corp. justly call for protection. This calls for the application of ethical standards of what is fair and equitable to particular sets of facts."

SEC. 3. TRANSACTIONS IN SHARES OF THE CORP. BY DIRECTORS, etc. (p. 525)

(a) PURCHASE OF SHARES FROM INDIVIDUAL HOLDERS.

not legally acquire, was rejected.

It seems to be generally accepted that if an opportunity to purchase comes to directors solely by reason of their being directors, they are liable to the corp. for any profit derived from it. It is immaterial that the corp., either for financial or for any other reasons, is unable to make the purchase itself, and immaterial that because of the corp's precarious financial cond. it might have been a br/duty to the corp. if the directors had caused it to make the purchase.

The Deutsch case seems to be right, but it is probably supported by the wt/authority. This is all called the "CORPORATE OPPORTUNITY" DOCTRINE.

Quere whether a director can buy stock in the corp. of wh he is a dir.? – Three views, among them the "Kansas view": full duty of disclosure owed. A refinement of Kansas view is the "half-truth" doctrine

wh requires accounting unless full disclosure is made.

Another view is: there is no duty to disclose except "special facts" (e.g., oil about to be discovered on the land). — These first two views are on the dir. approaches the s/h to sell. "Special facts" Doctrine:

Third view (majority) — no duty to disclose on the s/h has approached the dir., even on dir. knows special facts. Goodwin v. Agassiz, p. 525

Most modern cases, while following the majority rule, have approved the position taken in Strong v. Repide that the existence of SPECIAL CIRCUMSTANCES may create such a duty.

27 March 63

(b) DEVELOP. OF FED. CORP. LAW: RELATING PRIMARILY TO INSIDERS

(Chap. 78-1 Num 24 of G.S. of N.C.)

In addition to fed. S.E.A., all states have their "little Securities Exch. Acts" - called "Blue Sky Laws." These state Blue Sky Laws apply to corps. not in interstate commerce.

Two big sections of S.E.A. (1934) are sec. 16 and sec. 10(b), and S.E.C. Rule X-10B-5 wh amplifies 10(b). Though these sections are merely prohibitory, courts have generally interpreted them as being civilly remedial. Q. Thus is raised the Erie v. Tompkins rule: what about the s/l ? = 10(b) talks of fraud; so do we say that the s/l does not start

Incorporation and Organization

A. In General

1. No particular form of words is necessary in the charter; it is sufficient that the intent to incorporate is evident.

2. Incorporators must be competent natural persons. Usually must be at least two.

3. In practically all states, the incorporation for the purpose of carrying on the business of banking or insurance or other forms of business affected with a public interest must be had pursuant to the general laws applicable to those particular classes of business.

In Ga. petition filed w/ S/S.

*4. In case of statutes authorizing the incorporation of co-operative organizations, their main object being to enable men of small capital, or of no capital except their labor and their skill in trades, to form corporations for the purpose of giving employment to such capital, etc., the language expressing the purposes for which such corporations may be formed ought not to

narrowly construed, but should be given a reasonably liberal construction. Finnegan v. Noerenberg (Finnegan v. Knights of Labor Building Association), 52 Minn. 239, 53 N.W. 1150, 18 L.R.A. 778, 38 Am. St. Rep. 552.

5. Usually required that the purpose or purposes be stated in the articles of incorporation required to be filed.

Am. Jur. on Corps

Mechanics of Incorporation

1. Incorporation agreement.
2. Meeting of Board of Directors
   a. Adoption of Articles of Incorporation.
3. Issue of Stock
4. Articles (Petition in Ga.)
   a. Drafted
   b. Filed w/ Secy. of State or other appropriate official. (Presentation of petition to Judge: Ga.) Super. Ct.
   c. Filed at principal place of business w/ the clerk.

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* Steps in Ga. (See Ga. Code, Title 22, esp. 22-18 [Corp. Act of 1938]).

1. Obtain a certificate or statement from the Secretary of State that the name sought for the proposed corporation is available; then,

Cert. of Name

2. A petition or declaration must be prepared, in at least triplicate form, containing the required data and signed by the persons applying for the Charter or their counsel; then,

Prepare Petition

3. An order, also in at least triplicate form, approving the petition or declaration to be signed by the judge; then

Prepare Order

4. Both petition and order shall be presented to the appropriate superior court judge, who, when satisfied as to its form and content, will sign the order; then,

Presentation to and approval by Superior Ct. Judge

5. Both the petition and the signed order shall be filed in triplicate with the ~~Sec~~ clerk of said superior ct., who, upon pymt. of the necessary fees, will stamp the file same; then,

Filing of pet. + order w/ Clerk + pymt. of fees

6. The clerk shall forthwith deliver to the applicants or their attorney two certified copies of said petition and order, with the filing of the clerk thereon, and receipt of the costs paid; then,

Receipt of cert. copies of pet. + order from Clerk

Filing of cert. copies w/ Secy of State & payt. of fees.

7. The applicants or their attorney shall transmit these two certified copies aforesaid to the Secretary of State, accompanied by the necessary fees; then

Receipt from S/S of one certified set & certificate.

8. The Secy. of State shall retain and file one of these certified sets and shall return to the applicant or their atty. the other certified set, after having attached thereto a specified form of certificate of the Secretary of State; and,

Publication once a wk. for 4 consecutive weeks.

9. After having filed the petition and order with the clerk, as set forth in step "5" hereof, but in no event not later than within One week after the filing of said petition (unless otherwise ordered by the court), the applicants or their atty. must cause to be published in, and submit to said clerk an affidavit signed by the duly authorized agent or publisher of, an appropriate newspaper, four insertions of said petition and order, to appear once a week for four weeks.

The corporate existence of the corp. shall begin at the time of the filing of the petition or declaration, with the judge's order thereon, by the said clerk; but, it must be noted that the corp., although so and then created as a separate legal entity, shall not be licensed to transact any business until it shall have received the certificate from the Secretary of State in the manner hereinbefore prescribed.

What is a "short sale"? W/in 6 mos. of acquisition.

Kardon

to run until the fraud is discovered?

V. Nat. Gypsum Co. (p. 538)

Action for an accounting of profits due to alleged violation of Rule X-10B-5 and sec. 10(b).

Slavin's mot. that he had made no deal to sell the "stock" was misleading under the circumstances because it was an omission of a material fact: sale of ASSETS of the corp. Like a half-truth.

One of the first cases giving a civil remedy to P under sec. 10(b) and rule X-10B-5 even though neither the section nor the rule talks of an action for an accounting.

Ct. said, "In essence, the transaction is a sale by directors, in their own interest, of corp. assets, otherwise than in the course of biz and w/o disclosure to S/H." Held, "... the transaction (here) was in reality a sale of corp. assets."

The S.E.A. of 1934 "does no more than forbid certain types of conduct such it defines in gen. terms, in connection w/ the purchase of securities. It does not even provide in express terms for a remedy although the existence of a remedy is implicit under general principles of law."

Before this case, the S.E.C. handled these actions and merely made "stop orders" and / cease and desist".

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28 March 63

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* (Chap. VIII) FINANCING THE CORP. *

INTRODUCTION

Authorized Capital — that amt. orig. agreed upon w/ which to finance the operation, and it remains until and if amended. Two phases affecting A/C:

(1.) Pre-incorporation.
(2.) Post-incorporation

Now, when X comes in to buy stock based on A/C, is that a subscription, or is that a K for the sale of shares? (This is on point by X is still pending. X would prefer the K theory because in

Re the time when X buys the shares: →

* Quaere:

Assign: Chap. 8.

50

case of bankruptcy of the corp., X would contend y was failure of consideration and he is relieved and would not be a debtor of the Corp. —

(*) Creditors would say that this was a subscription giving X rights of participation, and that since the issuance of the certificates was only held up because X had not yet paid the money for the shares, that pymt. was really a cond. subsequent to the position of S/H. — Courts have developed a test:

If pymt. by X is a cond. precedent to rights of participation, then X should only be deemed a contractee. But, if pymt by X is only a cond. subsequent to rights of participation, X would be liable as a S/H. (See Stern v. Mayer, 166 Minn. 346, 207 N.W. 737, 46 A.L.R. 1167 (1926)).

Stern case says you must go behind the language of the agreement to deter. whether X = K^ee or S/H.

Further, that the results will be looked at to determine the question! (That's using hindsight to deter. intention!!) — This is a drafting problem: you must state in the agreement whether you intend the issuance of certificates (evid. of stock) to be a cond. subsequent or precedent to participation in the corp. If you have rights of participation before you (x) pay your money, you = subscriber and would be liable. — This case held that since X could not participate, he was not a subscriber. — The preceding applies to pre-incorporation period.

In post-incorp. stage, y is a presumption that X = S/H.

In post-incorp. period, cts. usually say that X would be a S/H because the corp. would be a going concern, and [redacted] X could participate right away, the certificates merely being evid. of shares anyway. So, for X to be a K^ee, that must be clearly stated in the agreement to rebut the presumption of S/H. — A going concern must have S/H, and it must have been intended that X would be a S/H em —

5✓

(got to class 11:05 A.M. – DR. H. THURMAN)

(SEC. 3.) WATERED, BONUS AND DISCOUNT SHARES (p. 740)

mediately, the certificates' issuance being merely incidental.

1 APRIL 63

NOTE: "WATERED STOCK" AND 2 to 1 Ratio. And see Jeff v. Utah Power and Light Co., 12 A.2d 592; 23 Minn. L.R. 484; 30 H.L.R. 39; 5 Ill. L.R. 87 (all re the "guilty shares" view); Pork Terr. Corp. v. Burge, 106 S.E.2d 478 (N.C.) – subscription to 100 shares of class A common at $1.00 per, and 49,097 shares class B at $1.00 per. Set up the 49,097 shares to be carried on the books. K and Leith Volan, architect, to pay $79,100: $9,000 cash + $70,100 in class B common. Volan then said he'd sell all of his class B for $5000.00. The corp. said it could not buy, but two of the directors agreed to take it personally and had it transferred on the books to them. As corp. progressed, the 2 directors then sold the class B back to the corp. for $221,000, and then B/D retired all class B. Then one director + the corp. filed suit to get back the $221,000. — Ct. said that it need not worry about it despite possibility of bad faith because Volan was no

longer in the corp. and no creditors were hurt. Thus, ct. said the S/H were not hurt nor was the corp. So, the "guilty shares" doctrine did not effect the court — at least under the old statute.

3 APRIL 63

Two theories of liability: (see p. 744)

(1.) Misrepresentation to Creditors — "trust-fund" theory: liab. is the diff. between the purported value of the shares and the amt. actually paid in money or value of prop. transferred or services rendered. See Hospes v. Northwestern Mfg. & Car Co. p. 749. The liability is "to or for" creditors. The subscribing holder of the stock is liable.

(2.) Statutory Obligation Theory — since the corp. is a creature of state creation, the corp. has a stat. obligation that cannot be K'd away, and watered or bonus or discounted stock would breach that obligation to issue shares at par. Most states have statutes stating (55-46) "No corp. shall issue either shares of stock or bonds, except for money, labor done or property actually rec'd. for the use and lawful purposes

of such corp."

G.L. 55-53 - (read carefully) re watered stock. Quere no-par stock as related to the question of watered stock. (b) - Liability for watered stock on orig. holder & he continues to be liable even after transfer; the transferee would be liable only on the took ex knowledge of the H_2O. (g) - Specified fiduciary parties exempted from personal liability except on he does not indicate he acts in a representative capacity, (and then makes a troublesome provision).

4 April 63

Hypo: Capital stock = $200,000 on wh Cors A, B & C rely. Then, a new issue of $100,000 is watered by $50,000 + that is relied on by Cors D, E & F. — Does the "trust theory" apply only to D, E and F, or would A, B & C also be deemed prejudiced by the watered $50,000? Since the "trust theory" rests upon the idea that y was a misrepresentation to Cors, A, B and C would not be prejudiced, and only D, E and F could benefit by the trust theory. — Another view is that the watered stock would run prejudicially against and dilute the whole $300,000, and that ∴ all Cors (A, B, C, D, E & F) would come in under the trust theory, and the [redacted] holder would be liable to all 6 Cors. — This just may be an area for the "trust-fund" theory breaks down.

These actions arise on the co. goes insolvent and the receiver sets out to marshal all assets of the co. The receiver then demands that the holders of watered stock make up the water.

8 APRIL 63

Easton Nat. Bank v. Amer. Brick & Tile Co. (p. 761)
64 A. 917 (1906, N.J.)

(Minority Rule)

Under the gn. corp. act of 1875, a Creditor's knowledge that stock was improperly issued as "full paid" and as "issued for prop. purchased," when the fact was otherwise, is not suff. to debar him from relief against the recipients of the stock.

A S/H who participated actively in a transaction that resulted in an improper issuance of stock as "issued for prop. purchased" and himself received a part of such stock, HELD Not estopped from participating AS A CREDITOR in proceedings taken to enforce the liability of delinquent S/H by the circumstance that their stock certificates were marked "full paid" and "issued for prop. purchased," since the S/H knew the fact to be otherwise. —

The agreement for improper issuance of the stock being absolutely void on ground of public policy, his rights as a Cr remain unimpaired.

Every Time
All creatures
Alma Mater

(Sec. 4) NO-PAR OR LOW-PAR SHARES (p. 799)

Historically any par less than $25.00 is deemed "low par", and usually it is found around $1.00 and lower. e.g., Piggly-Wiggly set up $.20¢ par on its stock.

55-47(c) -sets up "paid-in surplus" situation. Includes ~~low~~ par, but not no-par. (The paid-in surplus is segregated from surplus.) If par = $100 + it is sold at $120, the $10.00 difference goes to paid-in surplus.

* No-par must be capitalized at something, and some agreed amt. of the consideration paid must go into the capital account.

PREEMPTIVE RIGHTS AND FIDUCIARY DUTIES (AND EQUITABLE REMEDIES) (p. 828)

* Pre/rights - rights of a S/H (by purchase) to get in a new issue of stock, an equivalent no. of shares to maintain his relative or proportionate rank. e.g. X owns 1/5 of the stock + another million shares are issued. The corp. must offer X first the right to purchase enuf shares to maintain his proportionate balance.

Ballantine, sec. 209 – Pre-emptive rights to subscribe + fiduciary duty of directors – S/H are given by C.L. doctrine a prior right or option to subscribe for newly authorized issues of shares before they are offered to the public in proportion to their holdings. This right is intended to safeguard the holders against unfairness and dilution of their interest and voting power. It has been made subject to various exceptions on grounds of practical convenience and it may be ltd. by charter or by statute or by waiver.

Then came the qualification that the pre/rights attached only to a new issue of the same class of stock.

* Quaere delayed orig. issue? (i.e., on only part of the originally authorized issue is issued). The corp. would contend there are no pre/rights in an orig. issue. The S/H would contend they could lose their relative, proportionate rank. —

The are split here. * Dunleavy v. Duc. Ry. held on y is a delayed issue and a going concern, this would be a second issue and pre/ rights should attach. — Ohio ogrsd w/ the proviso that the issue of stock in question not come within three years of the orig. issue. If it does, no pre/ rights because the second issue would be a part of the orig. issue.

Today, this "delayed orig. issue" is mainly a drafting problem. Under 55-56, you can, by drafting, put in whatever pre/rights you wish. * Quaere if lawyer says nothing of pre/ rights in view of "expressio unis,

exclusio alteris" doctrine of stat. construction?? It would seem that pre/rights would be implied.

N.Y. has said pre/rights are "inherent", growing out of the ownership of the stock.

N.C. & Ohio say that there would be no pre/rights if not mentioned in the charter nor in the K of sale of the shares.

Pre/rights are not favored by the corp. because otherwise the corp. could sell to an underwriter immediately upon issue of the second block of stock and realize more profit than if the sale were made to the s/h w/ pre/rights.

Assign. – continue w/ pre/rights.

10 APRIL 63

In the big public-issue corps, due to drafting, pre/rights are less often found. They need the money for investment and the pre/rights would be a hindrance.

In the closely-held corp., pre/rights are still very important and more often found. "pre/rights in a closely-held corp. usually should not only be preserved but should be extended and strengthened ... made

applicable to stock issued for property as well as money!

Ballantine p. 490: The pre/right does not extend to the issue of shares in consideration of specific property or services or to discharge a bona fide debt or in a merger.

The pre-emptive right does not exist where the shares are issued for property. (But) advisability of this is questionable as is the closely-held corp.)

N.Y. is a value state: e.g., B/A worth $5000.00 but corp. paid only $2000.00. The $5000.00 can be carried on the books; as assets, y would be listed $3000.00.

Only is no pre/right extant, and sale is made to a majority S/H who results in "freezing" his position at the expense of the minority, would the minority S/H have any recourse? Who has the burden of proof: the one seeking to uphold the transaction, or the one alleging illegality of the transaction?

Hyman v. Velsicol Corp. (p. 853)

P = research chemist who developed new formula for an insecticide. A closely-held corp. was developed. P had the patent and was given 40 of 200 shares. The other 160 shares were held by two other men, 80 each. The three fell out, & Hyman pulled out and started a new corp. w/ his patent. The other two decided to re-capitalize by splitting the 200 shares 10 to 1, i.e. 2000 shares, and issuing another 6800 shares. They offered Hyman a proportionate share of the new shares. But, Hyman was broke and couldn't buy, and P alleges they knew he was broke; that, therefore, this was an oppressive design by the majority S/H to freeze out P. - Court said that under the facts, this was not oppressive and that the re-capitalization was needed and timely. But, it was implied by the ct. that if it could be shown that the majority S/H were trying to freeze out P w/ an oppressive design which was not called for, the P may have

been able to stop them (on a sort of quasi-fiduciary basis, despite usual rule that ∃ is no fiduciary duty among S/H).

Ct. said ∃ was no oppression because ∃ was a biz necessity. This was found as a matter of fact.

Assignment: remainder of chap. 8. After holidays, chap. 9.

Re exams:
(1.) Dir. responsibility
(2.) S/H " "
(3.) Dividends
(4.) Lewissohn case -
(a.) Guilty shares (note Ga. view, too).

11 APRIL 63

Ross Transport, Inc. v. Crothers (p. 845)

This said that ∃ was no offer of pre/right, but the ct. still looked to see if ∃ was a suff biz reason to avoid the charge of oppression. This case reached a result opposite from that of Valsical Corp., and said that (p. 851) the Dr failed to show "that the co. needed the money so badly and was in such a financial condition that the sale of the additional stock to themselves was the only way the money could be obtained." This is the BUSINESS NECESSITY theory again.

Rule of Law

i.e., On the corp. can show that its actions were justified by biz necessity, the S/H's argument of oppression is out of the window.

Good will is a corp. asset and

can be capitalized.

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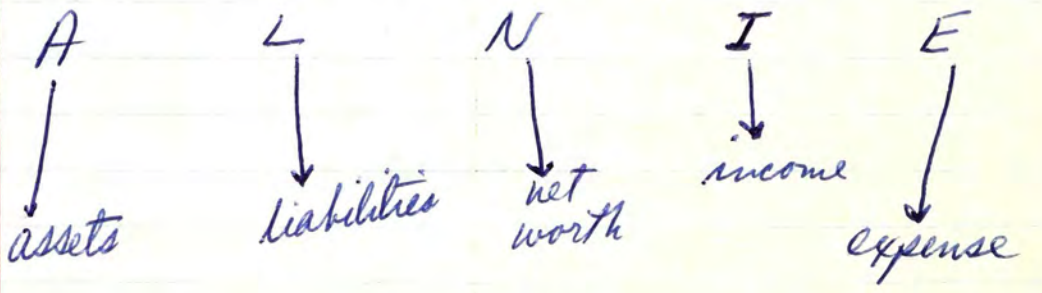
18 APRIL 63 (four)

(Gadly's notes)

Surplus net Profits - see G.S. 55-49 ; G.S. 55-50 ; 55-50.1.



[Surplus is the excess of net assets over stated capital. - N.Y. statute.

Read Randall v. Bailey (p. 955) for 4-22-63.

(consolidation v. merger?)

Missed class on 4-18-63 (four). No class on 4-17-63.

DIVIDENDS

22 April 63

Two tests of whether corp. is in the position to make dividends:

(1.) Balance Sheet Test - whether the assets side of the B/S exceeds the net worth and proprietorship side of the B/S.

Unrealized Appreciation - on a share of stock increases in value but the increase has not been realized. But, an unrealized appreciation will not set off an unrealized depreciation on the Balance sheet (B/S).

(2.) Earned Surplus (or "retained earnings") test.

Randall v. Bailey (p. 955)

The real question arises on the listed assets include many nebulous areas, e.g., goodwill value appreciation of land owned by corp. and investments that have appreciated value. e.g.,

HYPO:

(BALANCE SHEET)

ASSETS		LIABILITIES	
Goodwill	$3,000,000	$3,000,000	$6,000,000
Land (cost $2,000,000)	$7,000,000		
Investments (cost) ($2,000,000 = actual value)	$3,000,000	C/S	$3,000,000
Other fixed assets	$1,000,000	Surplus	$8,000,000
	$14,000,000		

Now, should ~~it~~ be a dividend declared out of the alleged $8,000,000 surplus? Creditors would argue that it is really no surplus, because the real, fixed assets are only $5,000,000, leaving a $1,000,000 deficit, and that a dividend would really "impair its capital or capital stock ...." — So, the question is whether these nebulous assets can be included in the assets of the corp.

New N.C. Statute G.S. 55 - 49(d) — speaks of only realized appreciations. See Cannon v. Wiskassett Mills, 195/119 — ~~22 April 63~~ said that dividends could be paid only out of surplus or net earnings. This case seems to line up w/ Randall case by saying that it is only a value problem and the burden is on the attacking party to prove that the "apparent surplus" ($8,000,00 in hypo) was not true and that those "nebulous areas" were not assets of the corp.

Randall v. Bailey said that [redacted] unrealized depreciation can be treated the same as unrealized appreciation. Dr. J. says this is the only case saying this.

Realized Appreciation Rule

Assign: next sec. of statute & Berks Case et seq.

But, the gen. rule is that an unrealized depreciation can be counted, but an unrealized appreciation cannot be recognized until it is realized.

24 April 63

Two basic methods of accounting re inventory:
(1) "FIFO" - first in, first out.
(2) "LIFO" - last in, first out.

Under FIFO in a declining market area, you would have a lower inventory value. But, under these facts using LIFO, you'd have a greater surplus, the theory being that you got rid of the cheaper goods first. — Either method used, whether in a descending or ascending market, will affect the inventory listed as an asset. Thus, if u are two cans of beans, one = $.12, one = $.05, and you allege that the .05¢ can was sold, thus listing the $.12 can as an asset. This can be allegorized to the case, supra, re a building owned by a Co. which is listed as an asset at

$7,000,000, but that $7,000,000 represents an unrealized appreciation of $5,000,000.

In a rising market, you would go w/ FIFO and allege that all the goods kept at end of the year are appreciated in value due to the rising market. So, in declining market, you'd go along w/ "LIFO!"

Rule of law: For dividends (cash or prop.), unrealized appreciation is not recognized. But unrealized depreciation is recognized. — So, if you're using the balance sheet test, you should adjust it to recog. unreal. deprec. and not to recog. unreal. apprec.

Key cases in this sec. —
Randall v. Bailey (p. 967)
Berks Case (p. 976)
Goodnow Case, (p. 995)

Q. — Is a diff. between net profits and net earnings? Some contend that net earnings are not net profits until the net earnings are set off against any deficits. e.g., From Jan. to June, a $2,000 deficit is incurred. From June to Jan., $5,000 in receipts in excess of cost (i.e., net earnings). Can the $5,000 be used for dividends or can only $3000 be

Organizational expense is an asset !!!

be paid? Under note 5, p. 999, the answer would be $3000 which would be the net profits.

N.C. talks of "net profits" but probably means net earnings, and would allow paying the $5000.00 as dividends. A very liberal dividend statute. New statute. — But, under this rule, after the P+L stat. (profit and loss) you would have a Bal. sheet deficit of $2,000.

Godwin Case (p. 995)

"Net profits" means net profits, not net earnings.

N. C. stat. says "regardless of impairment of capital." Hence, the full $5,00 dividend could be declared, and the $2,000 deficit, even if it impairs capital, would not be illegal.

24 April 63

Practically all state stats. preclude a div. on the corp. is insolvent or would be if it were to declare a dividend. But, a div. is allowed on y is a deficit! [y can be a deficit merely by capital impairment.] Del and M.H.J. has trouble resolving these because he cannot see allowing a div. before the deficit is dissolved!

All stats. agree that surplus = #1 source of div. Most allow div. out of net profits, and a couple (N.C.) allow div. out of net earnings.

If div. declared out of net earnings, the declaration must be at or a reas. time after the particular period.

Y can be div. declared by capital reduction. i.e., the corp. reduces by charter amend.; ~~redu~~ the capital. If it's a going concern, theoretically you would not need consent of Cors because the Secy. of State would okay it. The Secy. of State would have to okay the charter amendment.

Another source of div.

Liquidation Ratio

would be partial liquidation. 55-50 (c) & (g) allow this, but only on the assets of the corp. are in excess of the needs of biz by at least twice the amount of liabilities. [Liquidation = destribution of assets or cash in lieu of assets.] Many states follow this. Okla. = 4 to 1 ratio required. The I.R.S. says it would be no income there as a result if the partial liquidation eventually leads to full liquidation.

"Wasting assets corp." = a corp. wh, by its nature, uses up its assets (e.g., patents, oil). Q. Here, could dividends be declared before the assets waste away, or must the corp. wait until the assets waste away and declare div. out of surplus if ~~y~~ be any? Pa. said it would make no difference (coal mines), but some cts. say that you ~~must~~ may start only after the assets waste.

out of obsession

(b) LIABILITY OF DIRS. & S/H
(p. 1027)

54 In N.C., see G.S. 55-32+ (place liab. on dir. and S/H, respectively).

Would a dir. be liable for the dishonest actions of an agent? An early English case involved a bank. The chairman of the B/D and the gen. mgr. were dishonest and put on the books false accts. in the bank's branches + made the "big picture" brighter than reality! The B/D voted a dividend based on this false "picture" of the bank's business posture. There was a mgr. of branches who was honest. The Court HELD the directors would be liable for relying on their agents if an "honest agent" would have been put on notice of irregularities. Thus, the HONEST AGENT THEORY of dir. liability.

N.C. statute says that a dir. who votes for, or assents to, a declaration of dividends in violation of the statute shall be liable, etc.

S/H — what would be the liability of S/H for receiving an

cc LF LESTER B Murray

illegally declared dividend?
[In some states, the good faith of a dir. will not be a defense. E.g. N.C. says that if a dir. "votes for or assents to", he will be liable, and no mention is made of good faith. It seems that a type of strict liability is thereby imposed.]

Suppose the S/H receiving the dividend knew of its illegality. Quaere?

Re dir., if s is no good faith, or, if s is good faith but "culpable neg. in the big sense", the dir. will be liable. This is true in most states, and they say the action runs from the time of discovery (that's usually the rule in fraud cases, so this sounds in fraud). — The N.C. stat., actually, is unclear in 55-32 re good faith. If, in N.C., the S/L begins to run from the time of discovery of irregularity, that makes the action one sounding in fraud, and good faith is gen. a good defense against fraud.

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However, 55-B4 (re. S/H) does say that good faith = defense in receiving the dividends. Thus, knowledge of S/H of irregularity would vitiate defense of good faith.

The statute (55-32) says that dir. would be jointly and severally liable. If dir. A is the wrongdoer, and he is held liable severally, dir. A should be ~~allo~~ denied contribution from the others on B/D; and Ballantine even says that even if A, B, C, D and E, directors, were jointly liable but A was sued severally, A should be denied contribution. Reason: each dir. declared the dividend and should be individually liable.

Ballantine and Latlin agree that "it is unclear" whether ∃ could be subrogation in the above case for contrib. was denied.

64 N.Y. 173 } follow
37 P. 1078 } Ballantine

95 N.W. 16 - contra to Ballantine

221 S.W. 130 - some dictum favoring contribution.

2 May 63

Div. differ from interest in that int. accrues, and div. exist only on declaration and setting aside.

So dividends don't exist until there is first a declaration by the B/D. Some cts. say the dividend does not exist until the funds are set aside and only then does the dividend become irrevocable. — This prob. is not too often found.

What can a S/H do to push the B/D to declare a dividend? In Dodge v. Ford, Ford was trying to ruin Chevrolet out of biz and did not declare any dividends so that the surplus could be used to cover costs incurred by trying to undersell Chevy. Dodge = S/H who tried to compel declaration of div. but Ct. held against Dodge, saying he did not have standing to sue. Court said the directors could use their discretion in declaring dividends, and

they can refuse to declare the dividends on the ground of "biz purpose." — What ≠ biz purpose?

Re compelling declaration of div., see 234/331; 222/484; 241/491 (all under the old statute). Would a bona fide biz purpose be a defense to a suit to compel dec. of div. on "gen. equity principles" (new language)?

How does the dividend relate to the stock? Is it, when declared, separate from the stock, or is it an incident of (or to) the share of stock? Does the div. "run" w/ the stock"? The prevailing view is that the declaration severs the dividend, and thus the dividend would not of itself run w/ the stock.

Quaere div. in shares rather than cash? Are the new shares part of the old, or are they severable?

hypo: A ⟶ T in trust 1000 shares of X Corp. stock to pay the income to B w/ corpus to C.

Dela. in accord w/ Pa.

X corp. declares div. in stock. What, if anything, would B get? Would it be "income" or "corpus"? Three views:

1. Mass. View – only corpus because it does not enhance the existing stock.

2. Pennsylvania View – it would be income because the stock dividend replaces what would have been available for distribution.

3. "Carolinas' View" – strict apportionment: so much to income bene., and so much to corpus bene.

To find stock div. as income gives the income bene. greater weight in the corp. than he was intended to have by the settlor. —— Really a drafting problem, because neither the corp. nor the court can defeat the clear intent of the settlor.

hypo: X corp. declares div. on 3-1-1960 to be paid on 4-1-1963. On 3-15-63, X corp. becomes insolvent. Can the directors merely revoke their declara-

tion? Split here. Some say that upon declaration, severance of the div. from the assets occurs and the S/H can stand in line w/ Cors to get first crack at the corp. upon liquidation.

6 May 63

STOCK DIVIDENDS

See Eisner v. Macomber, 252 U.S. 189; Koshland v. Helvering, 298 U.S. 441.

*Eisner Case - (name case) a common stock div. paid to common stock holders did not = income for the purposes of the 16th A. because it did not interfere w/ the prop. of the corp. nor did it increase the proportionate interest of the S/H in the corp. It only dilutes his existing ~~interest~~ share. e.g., One share = 1/4 interest. Co. declares stock div. of 1 for 1, so that S/H has now 2 shares, each = 1/8 interest.

*Koshland v. Helvering (Tennant's Collector of Internal Revenue) - said that stock div. ≠ income, but if the div. was in common stock and was declared in favor of a

preferred S/H, that = income because he would then have a different additional interest. — So, when you begin to cross class lines, watch out.

Secs. 305 & 306 of 1954 Int. Rev. Code seem to say any declaration of div. to any preferred class of S/H = income.

STOCK OPTIONS

When you buy stock AND a stock option, you can probably allocate the basis of the stock to the option, so that upon sale of the option you would have the amount of taxable income cut down. — This is raised here because this will be important when advising directors on dividends. These ramifications must be considered. — You could declare the preferred div. in cash, and the common in stock so as to freeze some of the assets in the corp.

Guaranteed dividends — dividends provided for by the by-laws. Some cts. say this means "guaranteed if earned," and that to hold otherwise would = preferring those S/H to cors.

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Rights to Dividends Based on Types of Stock Ks.

Several classes of dividend stock:

(1.) Preferred cumulative stock -
  (a.) Participating
  (b.) Non-participating

Pref. stock usually gives up its voting power in favor of preference. Cumulative - the div preference given by the pref. stock will accumulate each div. period. So, if you a 6% preference, that will be rates. first and will accumulate. It is somewhat like a debt except that it lacks the dignity of the debt.

Participating - After preferred cumulative S/H have been satisfied, can they now come in and participate in the balance w/ the common s/H? - Yes, if it is participating preferred cumulative stock and it is an express (104 A.44) (6 A.L.R. 880) provision for it. Contra: 111 A. 536, 13 A.L.R. 462; 33 Mich. L.R. 968; 2 Chi. L.R. 133. — U.S. Sup. Ct. said it can see nothing wrong w/ participation (259 U.S. 156) if the preference is ltd. to dividends. (Whatever that means!)

Cumulative - if y are no 1960 earnings, that 6% will accumulate until the next year, so that when the corp. has earnings in 1961, S/H is entitled to two 6%'s.

Assignment: finish div. - and go to Chap. 10.

8 MAY 63

Belk v. The Belk Dept. Stores, 250 N.C. 99— See this for N.C. view.

Non-cumulative stock — holders hereof would have claim only if dividend is declared during the period. If no div. is declared during the div. period, there will be no carry-over. Either get it then or not at all.

hypo: One class pref. cum. at 6%
one class " non-cum. 5%, &
one class of common. No div. declared 1960, 1961. In 1962, 30% earnings (as in 1960 + 1961) and they do decide to declare div. — Pref. cum. would be entitled to 6% each of the 2 years, but pref. non-cum. would only get 5% in 1962. So, that would = 23%, leaving 7% for common. — This has been criticized because this puts pref. non-cum. at the mercy of a Board (which is often "common inclined"), so that the money of pref. non-cum. S/H is being used w/o giving them any benefits.

Some Ks provide that y can be div. declared to cumulative

"Cumulative if earned" view — on years adequate earnings to give non-cum.

s/H in such years that the profits exceed ~~X~~. – Another meaning of cumulative shares, i.e., cumulative if earned beyond ~~another~~ a certain point.

pref. s/H div., but y is no declaration, the mere passage of time should not defeat the s/H's claim for that period. — A few states follow this. The states contra say that this reads into the corp! — pref. non-cum. s/H ~~K~~ a cond. not intended nor supposed to be there.

The above confusion was caused by loose language of Holmes, J. in the Wabash Ry. case. The result based on that language would seem to be that the pref non-cum. s/H could not compel dividends for 1960 and 1961, once those years had passed, but that the B/D could, in 1962, voluntarily grant them dividends for those years. And, on the B/D as does, under 55-32, the B/D would seem to still be protected against common s/H's claim of unlawful distribution of corp. assets. — This cuts the distinction between cum and non-cum. down to the core (y would then be cum. and "cum. if earned").

Called "div. credits" ←

See San Juan Case clk. 734 – a must!! And read Wabash R. v. Barkley (see Ballantine) – 280 U.S. 197.

240 N.C. 49 – Seaboard Airlines Case – see this!

Convertible Share (or Bond) — used to raise money. A share is sold which can be later converted to a bond, or a bond is sold which can be later converted to a share. The option to convert can be in the corp. or the holder, depending on the K. — often used in new and growing corps. rather than issue comm. stock and have div. accumulate to a staggering amt. which = a quasi debt (comes in after gen. cors but before distribution to common S/H).

SEC. 2 PURCHASE AND REDEMPTION BY A CORP. OF ITS OWN SHARES. (p. 1050)

Another method of distribution of corp. assets is the purchase by corp of its own shares. Orig. corp. could not "traffic" in its own stock. Today okay as long as it purchases its shares out of surplus.

Gen. Rule

One court says that would be "trafficing" if the result is that net assets are left less than outstanding liabilities.

55-20 See 55-52(c) in N.C.G.S. (5 situations set out) which allows purchase by corp. of its own shares out of surplus "provided that...."

N.C. does not allow the purchase here

23
36

if y are accrued div. or div. credits which are unpaid.

Gen. The acquired "self stock" is put in the treasury of the corp. & listed as an asset. De J. has trouble seeing or giving asset here: "Corp. would not be getting anything it did not have before!" — However, the gen. rule is widely and generally accepted today.

How does this affect Corp? In long-term Corp stays De J., are put to the risk of insolvency.

One reason for buying its own stock may be to retire it and thereby reduce the corp's. capitalization so that y would be more assets. Qaare the effect of a reduced capitalization on Corp?

(23 Law + Contemps. Probs. 363, Lathy.

→ NOT ON EXAM

9 May 63

Chap. X ORGANIC CHANGES: Mergers, Recapitalizations and Charter amendments

(G.S. 55-99)

Sec. 1 Mergers, Consolidations, Sale of Assets or of Stock — Corp. Acquisitions.

Merger — one corp. swallows up another corp. and biz continues under name of swallower.

Consolidation — on two corps. fuse into one and do biz under NEW name.

Any dissenting S/H (who objects to organic changes) can have the right to be bought out.

Quere organic changes on c are dividends in arrears and the pref. cum. or pref. non-cum. S/H want to protect their accrued rights? — S.E.C. says that if a substantial return can be reas. anticipated due to merger so that the S/H due arrearages would get their due, and if this is equitable, reas. and fair (Dep Rock Doctrine), merger may proceed despite outstanding ch-rearages in dividends. — State law on this point = unclear.

Can S/H vote shares or must

they vote classes? N.C. statute says they would vote by class. 55-101 = organic changes (and even votes on div. arrearages) must be by class votes, e.g.,

C/S 200,000 sh. common
100,000 sh. preferred

Class voting would require majority in each class — 100,001 sh. common.
50,001 sh. preferred

Share voting would require a majority of shares regardless of classes. So, if you had 200,000 sh. common saying yes, and only 40,000 sh. preferred saying yes, the matter would still be voted in.

Class voting = method of protecting one class from being overrun by another class.

55-101 (b) — An objecting S/H shall have the right to be paid the value of his shares w/in 90 days (30 days for the decision by objectors to be made, 60 days for actual pymt.), i.e., be bought out.

Suppose the corp. is not in the position financially to buy the S/H out? Maybe the "projected earning theory" of the S.E.C. is a good solution.

* The State is a party to corp. charter Ks; thus, any state law

30 days to make demand for purchase, 60 days to get pymt.

pertinent to it will be deemed "read in" and will become part of the charter by implication.

By class vote, any div. arrearages can be wiped out, and any dissenting s/h has the right to be bought out.

TAX CONSEQUENCES — (p. 1069)
I.R. Code speaks of "sales and exchanges of assets and property. If it is exchange of stock-for-stock, no tax because that would be dealing w/ the assets while still in property form. If it is an exchange of assets purely, then maybe tax consequences.

55-112 = gives directors some independent powers w/o necessity of going to s/h. So, this is one way of getting around dissenting s/h & organic changes.

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13 MAY 1963

Many states have a reserve power statute: (55-174) the legis. reserves power to amend or change any charter law or by-law of any domestic corp.; & by implication it is read into corp. charters.

Under old N.C. stat., even w/ charter amend, accrued rights could not be wiped out (eg. accrued dividends). Durham v. Henrietta Mills, 216/728.

Quaere effect of mergers & consolidations on executory Ks? See 13 Minn. L.R. 81, "After-acquired Property."

Realty & Invest. Co. v. St. Louis Baseball Cardinals, 238 S.W. 2d 321.

Q. Is a merger an Amt by operation of law? = Assignments became an important issue in the old Western Union Co. Case. W.U. bought up Postal Telegraph Co., so by virtue of merger Postal had many customers who dealt w/ Postal to avoid dealing w/ W.U. — Several courts say that these Ks go over to the acquiring corp. but not by Amt; thus, the non-assignability clauses in the Postal Ks did not prohibit these acquisitions because they were not "Amts." — Could be

60 Harv. L.R. 1092

governed by drafting (e.g., "in case of organic changes, the K is to be re-negotiated.")

Qware "valued employees"? Can the acquiring corp. succeed to the Emt K of the acquired corp. re/ its valued Es (e.g., chemist, inventor, patent holder)? Courts say the Ee could not be held to his Emt K because it is a personal K, and the suggestion has been made that it would even violate the 13th A. to enforce the K of Emt - involuntary servitude. See 52 Harv. L.R. 526, "Emt Ks & Stat. Mergers" (says the Ee may hold the surviving corp. to the K). i.e., Ee could enforce the K, but the acquiring corp. could not enforce it! (A weird result.)

Colortype Co. case, 188 U.S. 104 (Holmes J.)

Qware labor Ks? Becomes even more complicated on q is consolidation. Cts. have gone several ways. See Commercial Telegraphers Union v. W. Union, 53 F. Supp. 90 — case on W.U. & Postal Co. merged into W.U. Said that the acquiring corp. should not be enjoined from disregarding the labor K of Postal Corp.

Also, 189 F.2d 177, aff'd. 342 U.S. 237, Longshoremen's Union v. Juneau Spruce Co. — Ct. said labor agreement was like the rights of any other Co., and the acquiring Corp. would not be bound by the Labor K. The parties should have protected against this by drafting.

Sec. 7 of the Clayton Act (Anti-Trust)

"... substantially lessen competition and tend to create a monopoly." Any mergers in any line of biz in any part of the country in any matter affecting commerce, which "substantially lessen competition and tend to create a monopoly" are held unlawful, and the Fed. Govt. is brought in and can stop the merger (statutory merger, consolidation, purchase of assets).

Western Union got away w/ buying Postal Tele. Co. because this is a business akin to public utilities, and monopolies in pub. utilities are gen. allowed and we have been conditioned to accept this. See "16 Year Appraisal of Section 7", 43 Va. L.R. 489.

Roosevelt in a Chicago speech, called for stricter enforcement of Sec 7 of Clayton Act because he felt ~~that~~ they (the) big corps. were swallowing up all the others. He said, "We are fast approaching the day when a 4 inch tail will be wagging a 96 inch dog."

15 MAY 63

REVIEW

Could officers have contribution over against dirs. on the officers have had to pay? If the action was brought on the several liability of the officers, there would probably be no contribution. If on their joint liab., as is a split of author. — Scott says there can be contrib. and indemnification by implication; Bogert says, no, unless there was an express agreement so providing. If G.S. 55-32 says for what matters officers and dirs. shall be jointly and severally liable. P Del. feels that, logically, Scott's view is better.

Corp. by estoppel is treated the same way as a corp. de jure and de facto, except that the corp. by estoppel is subject to quo warranto action, unlike de jure corp. ("K" between State, corp et al).

Once corp. comes into existence, what happens to the promoter's liability to creditors? Views:

(1.) Corp. can adopt promoter's liab., but that would not relieve the promoter; would only give the cor. a choice of parties to sue.

(2.) Novation — the corp. substitutes itself

for the promoter, and the corp. would then be solely liable to the Cors.

What happens on corp. comes into existence and does nothing. Some courts talk of ratification, but that is faulty (Def.). Actually, the major. of Cts. say that if its the type of K ~~ch~~ the corp. can accept or repudiate, doing nothing (and accepting the benefits) is held. to be either adoption or novation. Wattin says it is "loose estoppel" (not strict because the corp. did nothing to induce the (Cors). Most Cts. follow Holmes' view that ~~that~~ would be novation worked on the corp. does nothing (and accepts the benefits) after coming into existence. — As an advising atty, include in the promoters K a novation clause providing his obligation would terminate upon the corp. coming into existence. — Def. says this would be more of an adoption than novation because there is nothing showing that the promoter is relieved since the corp. does nothing except accept the benefits.

Not
call
the

Fraudulent Promotions —

Big problem is one of accounting and how were going to

treat the promotional steps. (Look this up!) Rugg has the best view, w/ Cardozo supplying the exception. Major. of cts. follow Rugg view that you must look at the overall transaction. May matter whether the promoters took par or no-par stock because even if the promoters did nothing, that would still be sufficonsid. for no-par.

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16 MAY 63

Cumulative Voting —

(G.S. 55-67) (Sub. sec. (c)) You can only eliminate cumulative voting by agreement among S/H.

Staggered Board —

G.S. 55-26 - designed to curtail effect of cum. voting. Under N.C. statute, ∃ can be staggered boards of only 9 or more men. The purpose of that limitation is to prevent the Board from being taken over by a minority. — N.J. and N.Y. have similar statutes.

Derivative Suits by S/H —

Ou Corp. has c/a but the dirs. are so tied up w/ it that that cannot or will not bring the suit, the dissenting S/H can bring the

Not covered specifically in class: thus, not on exam.

suit and must join the corp. as a defendant (cannot force corp. to be a P because a P is a purely voluntary thing).

Ga. - upon signing of the order by the Judge of the Superior Court, corp. comes into existence. But, must file order with the clerk of Superior Ct. and publish order once per week for four weeks.

De Facto Corps - most stats. say that a corp. shall come into existence upon the FILING of the articles by the State Office.

Categories covered by course thus far:
1. Corp. itself - entity concept, etc.
2. Role of promoters, directors + officers.
3. Role of S/H.
4. Corp. finance.
5. Fundamental changes (not on exam).

Also, note "guilty shares doctrine."

Declaration of Dividends -

The majority view is that the corp's liab. arises as soon as div. are declared (not necessary to wait until they are set aside) and here only can S/H compete w/ Cors on a pro tanto basis.

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