

CORPORATIONS

6 February 1998

I. ORGANIZATION OF CORPORATIONS

A. Formation Requirements (people, paper, act)

1. Incorporators (people)

- An incorporator **signs** the articles & **delivers** them to the Secretary of State
- An incorporator **adopts the initial bylaws**
- An incorporator **selects the initial directors, president, treasurer & clerk**
- An incorporator may be either a NATURAL PERSON

2. Articles of Incorporation (paper)

- purposes of articles
 - CONTRACT between the Corporation & Shareholders
 - CONTRACT between the Corporation & State
- required information in articles
 - *names & addresses*
 - The Corporate Name must show a corporate status (Inc. or Corp.)
 - Must also name the Incorporators & show a statement of intent to form a corporation
 - *statement of purpose*
 - MA requires that **EACH purpose** for which the corporation is formed must be **stated in the Articles** (≠ rest of country where say ‘for any lawful purpose’)
 - Plus, unless limited by articles, a Corporation has the **POWER** to **Acquire or use Real or Personal Property**, to **hold stock** in other corporations, to **purchase its own shares**, to make **charitable** donations irrespective of corporate benefit. Also, power to do things which are **Necessary & Convenient** to effect its lawful purposes
 - *ULTRA VIRES as a DEFENSE in a CONTRACT CASE depends on whether or not Performance has begun*
 - If **NEITHER** side has begun performance, then **BOTH** parties may be **RELEASED** from performance of the Contract due to Ultra Vires
 - If **PARTIAL** performance has occurred (including complete performance by one party) then the Parties may be Released, but the court will Award **FULL VALUE** for the Performance, under **QUANTUM MERUIT**
 - If **FULL** performance by **BOTH SIDES**, then the Contract May not be attacked
 - **ULTRA VIRES** is **NEVER** a Defense in **TORT** or **CRIMINAL** cases
 - *capital structure (stock)*
 - Authorized Stock: Max. # shares a corp. may sell
 - Issued Stock: # of shares the corp. actually sells
 - Outstanding stock: # shares issued but not re-acquired
 - Articles require, Authorized, Par Value, Voting Rights, Preferences & privileges of each

3. Act

- must **FILE** the Articles with the Secretary of State. The Secretary then examines the Articles; if accepted, Secretary makes a ***certified statement of incorporation***. Acceptance of the articles is Conclusive Proof of Valid Formation (*de jure formation*)

B. Legal Significance of Formation of Corporation

1. A corporation is a **SEPARATE LEGAL ENTITY**. It can Sue & be Sued.
2. Generally, Shareholders are **NOT PERSONALLY LIABLE** for the Debts of the Corporation. Principle of **LIMITED LIABILITY**.
3. If corporation is **NOT VALIDLY FORMED**, the **ACTIVE** (not passive) Investors are **PERSONALLY Liable** for the Debts, Torts, & Contractual Breaches of the Corporation (note, MA is in the **MINORITY** here, since the Majority of states hold that with an Invalid formation, ALL shareholders, both Active & Passive are personally liable)

C. De Facto Corporation & Corporation by Estoppel

- Though a Business **FAILS** to Attain De Jure Corporate Status, it is nonetheless treated as a Corporation (so shareholders are **NOT Personally liable**)
- **De Facto Corporation**: Requirements:
 - State has a *Relevant Incorporation Statute*
 - Parties Made a **GOOD FAITH** effort to Comply with it
 - Parties *Exercised SOME corporate privileges*
- If Applicable, **TREAT** the business as a Corporation for All purposes except in an Action with the **STATE**. Failure to file the Articles probably means that this is **NOT** available.
- **Corporation by Estoppel** (May have been abolished in MA)
 - If a Party deals with a business as a corporation and treats it as a corporation, that Party will be Estopped from denying that business's corporate status. Really only works in Contract Cases.

D. Bylaws

1. A *De Jure* Corporation Can Exist **without** bylaws. Adoption of Bylaws is **NOT** a condition precedent to the formation of a corporation.
2. **Incorporators Adopt** the Initial Bylaws
3. **Shareholders MUST** be the ones who **Amend** the bylaws. Although Directors may be permitted to Amend the bylaws by the Articles, they must still Notify the Shareholders of Any Amendments
4. If Bylaws **Conflict** with the Articles, the Articles **Control** (Bylaws are an internal document, of less *Dignity* than the Articles, which are a Public Document Filed with the State)

E. Pre-incorporation Contracts

- Promoter: a person Acting on BEHALF of a Corporation *Not Yet Formed*
- Liability on Pre-Incorporation Contracts
 - Corporation: A Corporation is NOT Liable on Pre-incorporation contracts **UNLESS** it Accepts the Benefits of the Contract
 - Promoter: Unless Contract provides to the contrary, generally, a Promoter REMAINS Liable on Pre-incorporation Contracts **UNTIL** there has been a **novation** (an agreement between the corporation, promoter & other party that the corporation will REPLACE the promoter under the contract)
 - note; merely having the Corporation ADOPT the contract is not the same thing as a NOVATION, Until Novation the Promoter is NOT Released from Liability (though with an adoption, the corporation also becomes liable)
 - note; the promoter may get INDEMNITY from the corporation if he is held liable

F. Secret Profit Rule

- a PROMOTER CANNOT make a **Secret Profit** on her dealings with the corporation
 - *Sale to the Corporation of Property Acquired **BEFORE** becoming Promoter*
 - Profit = Price Paid by Corporation - FMV
 - *Sale to the Corporation of Property Acquired **AFTER** becoming Promoter*
 - Profit = Price Paid by Corporation – Price Paid by Promoter
 - Note: Promoter is Liable on ONLY Secret Profits. Thus, DISCLOSURE of any profit is KEY.

G. Foreign Corporation

- Foreign Corporations Transacting Business MUST Qualify, or else.
 - Foreign Corporation = one incorporated outside MA
 - Transacting Business = Regular Course of INTRASTATE business activity
 - To QUALIFY: must get a **Certificate of Authority** from the Secretary of State. To Apply: must give information from the Articles and a **Certificate of Good Standing** from home State. Must appoint the State Secretary as AGENT for Service of Process.
 - If Do Business without Qualifying: CIVIL FINE + LOSE STANDING TO SUE (Corp. may be Sued in MA, but Can't SUE in MA)

II. ISSUANCE OF STOCK

A. Definition of Issuance

- Issuance = when a Corporation SELLS or TRADES its OWN Stock (not if a Shareholder sells or trades his corporate stock)

B. Subscriptions (Written OFFERS to BUY Stock from a Corporation)

- Pre-incorporation Subscriptions are **freely revocable until Acceptance**
- Post-incorporation Subscriptions are **freely revocable until Acceptance**
- A SUBSCRIBER becomes Obligated under a Subscription Agreement as soon as the BOARD Accepts the Offer. AT moment of acceptance, there is no longer any free revocation.

C. Consideration (what must the Corporation RECEIVE when it Issues Stock)

- Form

- **Permitted:** Money (cash or equivalent), Tangible or Intangible Property, Services ALREADY performed for the Corporation, a Debt or Note
- **Prohibited:** Future Services (RESULT in **Unpaid Stock** treated as **water**)

- Amount

- **Par** = Minimum Issuance Price
- **No-par** = No Minimum Issuance Price
- **Treasury Stock** = Re-acquired Corporate Stock. Stock which was previously issued and has been re-acquired by the corporation. The Corp. may resell it. Unless the Articles or Bylaws are to the contrary, re-acquired shares may be restored to *Authorized but Unissued* Status by a vote of Shares or the Board
- **Acquiring Property with Par Value Stock:** Use 5,000 shares of \$1.00 Par Stock to acquire a \$5,000 piece of property. Will be Valid so long as the property is Worth \$5,000. The Board's Valuation will be Conclusive if it was made *Prudently & in Good Faith*
- **Consequence of Issuing Par Stock for Less than Par Value (Watered Stock):** Buy Property worth \$10,000 by Issuing 15,000 Shares of \$1.00 Par Stock. The Corporation, or Creditors, may recover the Water via:
 - Corp v. Directors/Officers A Corporation files an Annual Report. Each Director who KNOWINGLY Signs a False Report is LIABLE to a creditor who relies upon it to its damage. So can maybe sue the Directors Officers.
 - Corp v. Purchaser of Watered Stock; People buying watered stock are liable for the amount of water they possess.
 - Corp v. Subsequent Purchaser of Watered Stock; The Subsequent Purchaser will NOT be liable for the Water if She Acted in GOOD FAITH (i.e., was a Bona Fide Purchaser). However, the Subsequent Purchaser's status (whether or not bona fide) has no effect on the Liability of Either the 1st Purchaser of the Watered Stock Or the Board/Directors who still remain liable.

D. Pre-Emptive Rights

- What:
 - Pre-emptive Right is the Right of an EXISTING Shareholder to MAINTAIN her percentage of ownership by BUYING STOCK whenever there is a NEW ISSUANCE of Stock for **Cash** (or Equivalent)
- When:
 - If Articles or Incorporation are **Silent**: then the Pre-emptive Right Does NOT Exist. The Pre-emptive right Exists ONLY if the Articles or by-laws EXPLICITLY State that pre-emptive rights are permissible
 - If the Stock is **NOT BEING ISSUED** for **CASH**, then the pre-emptive right is NOT Allowed. Pre-emptive Rights can NEVER be used in ANY NON-CASH ISSUANCE

III. ACTION BY AND LIABILITY OF DIRECTORS & OFFICERS

A. Statutory Requirements: Directors

1. Number of Directors
 - If **1** Shareholder, **1 or more** Directors
 - If **2** Shareholders, **2 or more** Directors
 - If **3 or more** Shareholders, **3 or more** Directors (No Limit on Number)
2. Election of Directors
 - *Initial Directors* are Elected by the **Incorporators** and hold office until the **1st annual meeting**
 - Board can be divided into as many as **5 classes**. At least 1 class's tenure must expire each year and NO class can be elected to serve MORE than 5 years or LESS than 1 year.
3. Early Removal of Directors
 - A MAJORITY of Shares entitled to Vote may Remove a Director with or without Cause
 - A MAJORITY of Directors may remove a Director, WITH CAUSE
 - If the Director is being Removed WITH CAUSE, then he is entitled to **Notice & an Opportunity to be Heard** (Due Process)
4. Filling a Vacancy of a Director
 - Directors select the person to fill the Early Vacancy, although the Articles or bylaws may permit Different Methods
5. Meetings of Directors
 - Meetings Are Required **unless ALL DIRECTORS CONSENT IN WRITING TO ACT WITHOUT A MEETING** (note, a Conference Call Qualifies as a Meeting)
 - **Notice** of Director's Meetings can be Set in the Bylaws (Notice is REQUIRED for Special Meetings)
 - **Proxies** are NOT ALLOWED. Neither are **Voting Agreements**. Hire Directors for their Judgment, want them to exercise it.
 - **Quorum**; Must have a MAJORITY of ALL DIRECTORS to **Do Business** (unless a different percentage is set in the bylaws). To pass a **Resolution**, require a MAJORITY of THOSE PRESENT. Note; **interested directors count towards a quorum**

B. Role of Directors

1. Manage

- Manage the business of the Corporation, set Corporate Policy, Supervise the Officers, Declare Dividends, Recommend Fundamental Corporate Changes, etc.

2. Delegate to Committee

- If Articles or bylaws so permit, the Board may delegate Substantial Management Functions to a Committee. However, Committees CANNOT Amend the bylaws, Change the Corporation's Principal Office, Select Officers, Remove Officers or Directors, Authorize the re-acquisition of Corporate Stock, or Other Distribution. Note the Litigation Committee to be discussed later.

C. Duty of Care (Burden on the Plaintiff to show a Breach)

- A Director owes the Corporation a DUTY of CARE. The Director must use the ***Diligence, Care & Skill*** that a **reasonably prudent person** would use under similar circumstances in like position
- Non-feasance (the director does nothing)
 - A Director owes the Corporation a DUTY of CARE. The Director must use the ***Diligence, Care & Skill*** that a **reasonably prudent person** would use under similar circumstances in like position
 - If a Prudent Person would do the things that the Director Failed to do, then the Director has breached his duty of Care. However, The Director will be liable only if that Breach CAUSED a LOSS.
 - WATCH for a *Failure To Supervise Officer*. A Director Can be Liable for the negligence of officers they Should Have Supervised. Key is the SIZE of the Company. In a Smaller Co. the Director would be expected to know more about the Day-to-day issues and actions of officers than in a large corporation
- Misfeasance (the director does something that loses money)
 - A Director owes the Corporation a DUTY of CARE. The Director must use the ***Diligence, Care & Skill*** that a **reasonably prudent person** would use under similar circumstances in like position
 - If a Prudent Person would not do what the Director did, then there has been a breach of the Duty of Care. However, even if the breach led to a Loss, the Director will not be liable if his actions meet the **Business Judgment Rule Standard**
 - A court will not Second Guess a Corporate Decision if that Decision was made ***in Good Faith, & on an Informed & Rational Basis***

D. Duty of Loyalty (Burden on the *Director-Defendant* to show Did Not Breach)

- A Director owes the Corporation a Duty of Loyalty. She must Act in **Good Faith** and with a **Reasonable Belief** that what she does is in the **best interest** of the Corporation.
- Interested Director Transactions:
 - Any Deal Between the **Corporation & One of Its Directors** (or a Director's Relative or another business of the Director's)
 - Standard: A Director owes the Corporation a Duty of Loyalty. She must Act in **Good Faith** and with a **Reasonable Belief** that what she does is in the **best interest** of the Corporation
 - The Interested Director Transaction **Will be SET ASIDE** unless the Director Shows:
 1. Deal is **FAIR** to the Corp. at time entered, **OR**
 2. Director **DISCLOSED** his interest & Got **APPROVAL** from a Majority of **disinterested directors or disinterested shares** (note: interested directors count toward a quorum for any vote)
- Competing Ventures
 - A Director owes the Corporation a Duty of Loyalty. She must Act in **Good Faith** and with a **Reasonable Belief** that what she does is in the **best interest** of the Corporation
 - A Director CANNOT Compete **DIRECTLY** with her Corporation. If she does, the Corp. will receive her share of the profits.
- Corporate Opportunity
 - A Director owes the Corporation a Duty of Loyalty. She must Act in **Good Faith** and with a **Reasonable Belief** that what she does is in the **best interest** of the Corporation
 - A Director CANNOT **usurp** a Corporate Opportunity. The Director may not take that opportunity before 1st **notifying the board of the opportunity**. If the Board Rejects it, only then may the Director Take it.
 - Note: The Corporation's Financial Inability to Take Advantage of the Opportunity is **PROBABLY NOT** A defense
 - When Breached, the **DIRECTOR**, if he still has the benefit of the transaction, he must **SELL** it to the Corporation **AT HIS COST**. (**Constructive Trust**) If he has sold it and turned a profit, he must disgorge the profit to the corporation.

E. Other State Law Bases of Director Liability

- Improper Loans
 - A Loan may be Approved by either a **majority of disinterested directors** OR **majority of shares entitled to vote for directors** if those voting find that it is reasonable expected to benefit the corporation
- Waste
 - Directors may not WASTE Corporate Assets by **overpaying** for property or services to such an extent that the payment = a gift. Charitable Contributions are NOT Waste. However, excessive charitable contributions may = abandoning the corporate purpose & exposing Directors to Liability
- Specific Director Liability for Ultra Vires losses, Improper loans or distributions.
 - General: A Director is PRESUMED to have concurred with Board Action **unless** the DISSENT is NOTED in the Corporate Records, such as:
 - Corporate Minutes*
 - Writing to the Corporate Sec'y (Clerk) at the Meeting*
 - Registered Letter to the Corp. Sec'y (clerk) post-meeting*
 - CANNOT dissent if Voted for Resolution at meeting
 - Exceptions
 - ABSENT Directors are NOT Liabile
 - GOOD FAITH RELIANCE on Corporate Records & Information, Opinions, Reports by Officers, Counsel, or independent CPA

F. Officers

- Owe the Same Duties of **Care & Loyalty** as the Directors
- Corp. are REQUIRED to have the Following Officers:
 - **President, Treasurer, Clerk (Corp. Sec'y)**
- The INITIAL officers are selected by the Incorporators
- Incorporators or Directors MAY appoint a **Resident Agent**, on whom Service of Process will be Made
- Resident Agent may be an **Individual** (resident of MA with a Business Address in the Commonwealth) or a **MA Corporation** or a **Foreign Corporation** complying with Requirements and Having an Office in MA
- **Treasurer & Clerk** are ELECTED (and may be removed with or without Cause) by the SHAREHOLDERS (unique: most states, every officer is elected by Directors)
- **President** is ELECTED (and may be removed with or without cause) by the DIRECTORS
- **All Other Officers** are Chosen in a Manner Determined by the BOARD
- **Officers are AGENTS** of the Corporation (Agency Principles)

G. Indemnification of Directors & Officers

- A Person **SUED** in his **Capacity** as *Officer, Director, Employee, or Agent* may be *indemnified* if the ARTICLES, BYLAWS, or VOTE of MAJORITY Shares so provides. Will Cover Costs incurred in Defending the suit, attorney's fees, and possibly fines, judgments or settlements.
- **Standard:** Duty of Loyalty. If person meets the standard, the corp. may indemnify.
- However, if the Case is BASED on a **Breach** of the Duty of **loyalty**, the Director or Officer may be REQUIRED to Refund the attorney's fees paid by the Corporation if the Plaintiff Wins (i.e., Defendant breached his duty of loyalty)
- ARTICLES May provide for the **limitation** or **elimination** of Director Liability to the Corporation or Shareholders for DAMAGES. However, CANNOT **Limit** the liability for Breach of the Duty of **loyalty, bad faith, unauthorized distributions, illegal acts, or intentional misconduct** (i.e., LIMITED to BREACH of DUTY of CARE cases)
- Corporation may maintain **Insurance** on behalf of Director, Officer, Employee, or Agent Against LIABILITY even if the Corporation would LACK the CAPACITY to Indemnify Against such liability

IV. RIGHTS OF SHAREHOLDERS

A. Holding Shareholders Liable for the Acts or Debts of the Corporation

- General: A Shareholder is NOT Liable for the Debts or Liabilities of a Corporation
- Exception: ***Piercing the Corporate Veil to Avoid FRAUD or UNFAIRNESS***
 1. *Alter Ego (Identity of Interests)*
 - Courts might Pierce the Veil when a Shareholder Treats the Assets of a Corporation as his OWN **Alter Ego** by Commingling Personal & Corporate Funds.
 - ONLY the Misbehaving Shareholder will be liable, the Shareholder who is Innocent of Treating the Corporation as an Alter Ego will NOT be Liable
 2. *Under-capitalization*
 - Courts might Pierce the Veil when a Corporation is Under-capitalized **when formed**.
 - Under-capitalization = Shareholders did NOT Invest enough money to Cover prospective liabilities (All Shareholders will be Liable)
- Note: Courts are generally more willing to Pierce the Corporate Veil for a TORT Victim than for a Contract Claimant. Also, most Courts NEVER Pierce the Corporate Veil at the request of 1 Shareholder

B. Shareholder Management of the Corporation

- In General, the **Board** *Manages* the Corporation
- But Statute, Articles, or Bylaws MAY Provide that Management is **Conferred** upon Shareholders
- In a **Close Corporation**, Shareholders can MANAGE a Corporation **directly**. Managing Shareholders owe the Duties of Care & Loyalty
 - Also, in a Close Corporation, every Shareholder owes a **Duty of the Utmost Good Faith** to every other shareholder (more stringent than duties of Care & Loyalty).
 - **Equal Access Rule**: Close Corporations must make Equal Access to purchase shares from EACH & EVERY Shareholder (can't purchase shares from a Majority shareholder without making an offer to every shareholder)
 - **Controlling Shareholders** in a Close Corporation CANNOT pursue Any Course of Conduct when an **alternative** exists that would be LESS **harmful** to minority shareholders
 - MA is very protective of Close Corporation shareholders. Look for Facts of Oppression in any essay question dealing with Shareholders of a Close Corp.

C. Shareholder Derivative Suits

- In a Derivative Suit, a Shareholder is SUING to **Enforce** the *Corporation's* Cause of Action (Always Ask: Could the Corporation have brought this suit?)
- Ergo, A Shareholder MAY bring a Derivative Suit on behalf of the Corporation in cases where another party breaches a contract with the Corporation OR a Director Breaches a Duty to the Corporation (but NOT if the Corporation issues new shares without honoring a shareholder's pre-emptive right)
- Generally, ANY Recovery in a Derivative Suit Goes to the Corporate Treasury, however, the shareholder may be indemnified for Expenses in Bringing and Winning the Suit
- However, if the Shareholder LOSES the suit, the Shareholder will NOT be indemnified and MUST bear the costs herself, PLUS the shareholder may be liable to the party whom it sued for Costs
- Once brought, no other shareholders may sue based on the same transaction
- REQUIREMENTS for Bringing a **Shareholder Derivative Suit**
 1. **Stock Ownership**
 - Person bringing suit MUST have owned shares at the TIME the Claim Arose OR have gotten shares by operation of law (through a will) from someone who did own shares at the time the claim arose AND MUST OWN Shares throughout the litigation
 2. **Demand upon Directors to Bring Suit before Commencing Derivative Suit**
 - Need not Demand the Directors if such a Demand would be **FUTILE**
 - Futility Arises if a Majority of the Board are the persons whom would be sued in a Derivative Suit for Breach of Duty
 3. **Demand upon Other Shareholders Before Bringing Suit**
 - If a Majority of Shares Vote NOT to bring a Derivative Suit, it CANNOT be filed **unless** the demand should be *Excused* by:
 - A MAJORITY of the Shares are CONTROLLED by a Potential Defendant (SJC case)
 - Demand is IMPRACTICAL due to # & Location of Shareholders (MA Dist, 1st Ct. App.)
 - Shareholders Fail to Respond After a Timely Demand (MA Dist. & 1st. Ct. App.)
- If a **Litigation Committee** REFUSES to *recommend* that the Corporation Sue and the Board Agrees, the Shareholder MAY Challenge the Refusal in Court. There, the Corporation has the **burden** of Showing that the Committee was **independent** & Acted **in good faith**. Even if the Corporation shows that the litigation committee was *independent* & Acted in *Good Faith* the COURT will **independently consider the reasonableness of the decision**
- There can be **No Dismissal** or **Settlement Without COURT APPROVAL**

D. Voting

- Who Votes

- General Rule: Record Shareholder on Record Date has Right to Vote
 - The **record shareholder** is the person SHOWN as the Owner on the **corporate records**. The **record date** is the date of Voter Eligibility Cut-off (given in facts)
- Exception to the Rule that Record Owner on Record Date Votes
 - When the **Corporation** is the Record Owner on the Record Date, the Corporation CANNOT Vote Treasury Stock
 - When a Shareholder **DIES**, an executor may vote if the Decedent was the Record Owner on the Record Date
 - **Proxies: WRITING, SIGNED** by RECORD SHAREHOLDER, DIRECTED to the CLERK (Sec'y) of the Corp. AUTHORIZING ANOTHER to VOTE the SHARES
 - Proxies are Valid for a MAXIMUM of **6 months** (will expire after the meeting for which it is given)
 - It is Valid to Revoke any prior proxy prior to the vote, even if the Proxy is titled '*Irrevocable*'
 - However, proxies coupled with an interest CANNOT be revoked (i.e., if sell shares AFTER offering a proxy, but before the annual meeting to which the proxy is to be used)
- Voting Trusts & Voting Agreements
 - **Requirements for a Voting trust**
 - **Written** Trust Agreement stating how Shares will be voted
 - **Copy** of the Written Trust Agreement goes to the Corporation
 - **TRANSFER** of LEGAL Title of Shares to the Voting Trustee
 - Original Shareholders Receive TRUST **CERTIFICATES** & Retain all other Shareholder Rights except for Voting
 - **Requirements for a Pooling Agreement**
 - Must be in **Writing** and **Signed**
 - May be Specifically Enforceable
- Where do Shareholders Vote
 - Shareholders may take Action **without a meeting** if there is *Unanimous Written Consent* of all voting shares
 - **Annual Meeting**, must be Held not later than 6 months after the close of the fiscal year (where directors are elected)
 - **Special Meeting**: can be called either *by the Board, by the President, or by the Clerk* upon application of the holders of at least **10%** of the voting stock
 - **Notice Requirement**: Must give WRITTEN notice to EVERY Shareholder entitled to vote for Every Meeting (annual or special). Contents of the Notice MUST state When & Where the meeting will be held, and the Purpose of the meeting. FAILURE to give PROPER NOTICE to ALL Shareholders will result in any action taken at the meeting becomes VOID **unless** those not receiving notice WAIVE the notice defect. The Express Waiver must be in WRITING & SIGNED before/after the meeting & filed with the record of the meeting

- **How do Shareholders Vote**

- There must be a QUORUM represented at the Meeting. Determination of QUORUM focuses on the number of SHARES represented (not shareholders). Generally, a Quorum requires a MAJORITY of outstanding shares (though Quorum Requirements may be fixed by the Articles or Bylaws to be higher or lower)
- If a QUORUM is present, the majority of those present may Act to BIND the Corporation UNLESS the articles or bylaws require a Higher vote.

E. Sale of Stock by Shareholder

- **Amount of Consideration**

- Any amount received as consideration is valid. PAR value applies ONLY to Issuance (so if sell for less than par, that is fine. Watered Shares only occur when the corporation issue stock for less than Par Value)

- **Stock Transfer Restrictions**

- Includes *Rights of First Refusal to the Corporation*. Can the Corporation bring suit against either the Selling Shareholder or Buyer of the Stock if the Stock Transfer Restriction is VIOLATED:
- **C.O.A. v Selling Shareholder: Look to Validity:** Will be Upheld provided that the Restrictions are REASONABLE under the Circumstances, which means they are NOT an UNDUE RESTRAINT on ALIENATION (so a Right of 1st Refusal is generally valid so long as the price is reasonable)
- **C.O.A. v Buyer of Stock: Look for Buyer's Knowledge or Notice:** Even if the Restriction is REASONABLE and VALID, it may not be invoked against the TRANSFEREE **unless either** it is *Conspicuously Noted on the Certificate* OR *the Transferee had actual Knowledge of the Restriction*

F. Right of Shareholder to Inspect the Books & Records of the Corporation

- By Statute, EVERY Shareholder may INSPECT the **articles, bylaws, records of shareholder meetings, stock transfer records, & shareholder list**. The Corporation may REFUSE ACCESS ONLY if it can prove that the SHAREHOLDER *intends* to sell the **Shareholder List** to Outsiders or Use it in an otherwise **improper** way
- Beyond this, ANY Shareholder can SEEK Access to Other Corporate Records if she can PERSUADE an EQUITY COURT that she has a *proper purpose* and is acting *in good faith*, so that failure to order inspection will cause her *serious injury*

G. Distributions

- Dividends:
 - Declared at the Board's **Discretion**.
 - Shareholders may Sue to **COMPEL** Declaration of Dividends ONLY if a dividend has *already been declared*, the *articles require* it, or there is a VERY strong showing of *Abuse of Discretion* (breach of fiduciary duty)
- Redemptions
 - A Forced Sale of Stock to the Corporation at a Price pre-determined in the Articles of Incorporation
 - Must be PROPORTIONAL within a Class of Stock
- Repurchases
 - Individually negotiated. Generally, the Corporation may *Discriminate* with a Re-purchase **except** in a *Close Corporation* in which the Repurchase MUST be made available to ALL shareholders (**equal access rule**)
- Which Shareholders get Dividends (preferred, participating, cumulative, common): After Declare a Dividend (\$X) who gets what?
 - **Common Stock:**
 - $(\text{Dividend Declared}) \div (\text{Common shares outstanding}) = \text{Dividend per Common Share}$
 - **Preferred Stock & Common Stock:**
 - **1st:** $(\text{Preferred Shares Outstanding}) * (\text{Preferred Dividend Value}) = \text{Preferred Dividend Payment}$
 - **2nd:** $\text{Total Dividend Declared} - \text{Preferred Dividend Payment} = \text{Remaining Dividend}$
 - **3rd:** $(\text{Remaining Dividend}) \div (\text{Common Shares Outstanding}) = \text{Dividend per Common Share}$
 - **Participating Preferred & Common Stock**
 - **1st:** $(\text{Preferred Shares Outstanding}) * (\text{Preferred Dividend Value}) = \text{Preferred Share Payment}$
 - **2nd:** $\text{Total Dividend Declared} - \text{Preferred Dividend Payment} = \text{Remaining Dividend}$
 - **3rd:** $(\text{Remaining Dividend}) \div (\text{Preferred} + \text{Common Shares Outstanding}) = \text{Dividend per Share (Common \& Add this to the Other Preferred Dividend)}$
 - **Cumulative Preferred & Common Stock**
 - **1st:** $(\text{Preferred Shares Outstanding}) * (\text{Preferred Dividend Value}) = \text{Preferred Dividend Payment}$ [*Repeat for As Many years unpaid as are given, so if 4 years unpaid, Preferred entitled to 4X Dividend Value*]
 - **2nd:** $\text{Total Dividend Declared} - \text{Preferred Dividend Payment} = \text{Remaining Dividend}$
 - **3rd:** $(\text{Remaining Dividend}) \div (\text{Common Shares Outstanding}) = \text{Dividend per Common Share}$

- Which Funds to Use in ANY Distribution?
 - A Distribution is PROPER if it is NOT Contrary to the Articles or a DEBT CONTRACT AND the Corporation is NOT Insolvent & WOULD NOT be **rendered insolvent** by the distribution. Although the Law does NOT specially preclude distributions from STATED CAPITAL, de facto, dividend may NOT be paid from Stated Capital (Par * Outstanding Shares)
 - Earned Surplus
 - Earned Surplus = All Earnings – All Losses – Distributions previously paid (essentially Retained Earnings)
 - Earned Surplus can be used to PAY Distributions (unless corporation is **insolvent** or making the distribution would render the corporation insolvent)
 - Stated Capital
 - Stated Capital = Par Value * Outstanding Shares
 - May NOT Be used for Distributions
 - Capital Surplus
 - Capital Surplus = Value Received in Issuance – Stated Capital
 - MAY be used to Pay Distributions (unless the corporation is **insolvent** or making the distribution would render the corporation insolvent)
 - The Corporation MAY make a distribution EVEN IF it LOST money in the prior year, however it CANNOT make a distribution if it is **insolvent** or the distribution would **render it insolvent**
 - **Directors** voting for an **improper distribution** are *JOINT & SEVERALLY LIABLE*. **Shareholders** receiving such distributions are also **LIABLE up to the distribution value received**. Note: the Directors may have a possible *defense of Good Faith Reliance*

V. FUNDAMENTAL CORPORATE CHANGES

A. Characteristics of Fundamental Corporate Change

- **Unusual Occurrence, so requiring a Board Resolution AND**
- **Approval by 2/3 of Shares Entitled to Vote** (QUORUM doesn't Apply)
- **Possibility of Dissenting Shareholder Right of Appraisal**
 - What is Right of Appraisal?
 - The Dissenting Shareholder's Right of Appraisal is the RIGHT of a Shareholder to FORCE the Corporation to Buy Her Shares at FMV
 - When does the Right of Appraisal Apply?
 - **Actions by the CORPORATION which TRIGGER the Right**
 - Certain Articles Amendments
 - Mergers
 - Consolidations
 - Transfer of Substantially All the Corporate Assets
 - **Actions by the SHAREHOLDER to PERFECT the Right**
 - Pre-Vote, Dissenting Shareholder must **File** a WRITTEN NOTICE of OBJECTION and INTENT TO DEMAND PAYMENT with the Clerk
 - The Dissenting Shareholder must either **Abstain** or **Vote Against** the proposed change; and
 - **Within 20 days** after **notice of deal approval**, make **written demand** to be bought out
 - What if Shareholder & Corporation Can't Agree on FMV?
 - The COURT will Appoint an *appraiser*

B. Amendment of the Articles

- **REQUIRES Director Approval + Shareholder Approval**
- **Minor** Amendments Requires a **Majority** vote of Each Class Entitled to Vote
 - *Change Par Value*
 - *Change Authorize Stock*
 - *Change # of Shares in a Class*
 - *Change of Corporate Name*
- **Major** Amendments Require **2/3** Approval by Each Class Entitled to Vote
- If Amending the Articles is APPROVED, the Corporation must **File** the Amended Articles with the State Secretary
- **Dissenting Shareholder Rights of Appraisal Arise** if the Amendment:
 - *Alters or Abolishes Preferential Rights*
 - *Creates, Alters or Abolishes Redemption Rights*
 - *Creates or Alters a Restriction on Stock Transfer*
 - *Excludes or Limits Voting Rights*

C. Mergers or Consolidations

- (The **President** or **Vice President**) AND (Treasurer or Assistant Treasurer) **SIGN** an *Agreement of Merger or Consolidation*
- 2/3 of the Shareholders of Each Class Entitled to Vote **MUST** Approve unless **short-form merger** where a 90% or More owned **subsidiary** is Merged into a **parent** corporation. However, Shareholders of the Subsidiary have **appraisal rights**
- If the Merger or Consolidation is APPROVED, File the *articles of merger/consolidation* with the State Secretary
- DISSENTING SHAREHOLDERS have Rights of Appraisal
- EFFECT of Merger/Consolidation: The **surviving company** succeeds to ALL Rights and Liabilities of the **constituent companies**. (Creditors CANNOT be harmed here)

D. Transfer (not mortgage) of All or Substantially All of the Assets NOT in the Ordinary Course of Business

- It is Usually a SALE but it could be a LEASE (but it is NOT a Mortgage)
- This is a FUNDAMENTAL CHANGE for the **SELLING Corp. ONLY**, It is NOT a Fundamental Change for the BUYING Corp.
- REQUIREMENTS:
 - **Board Approval** (of BOTH the Buyer & Seller)
 - **Shareholder Approval of Selling Corp.** (2/3 of Each Class Entitled to Vote, with Dissenting Shareholders retaining a Right of Appraisal). Note: no action is required on the part of the Buyer's Shareholders and they have NO rights of appraisal

E. Dissolution (3 Ways)

- Voluntary Dissolution
 - Requires Approval by **2/3** of the Shares of Each Class Entitled to Vote OR
 - Compliance with provisions in the Articles
- Petition to the Supreme Judicial Court for Dissolution
 - Court may ORDER Dissolution IF it finds that it is in the **best interests** of the shareholders.
 - Petition **done** by **Majority** of Each Class of Shares entitled to Vote OR
 - **40%** or More of ALL VOTING SHARES if the Directors are Deadlocked & the shareholders can't break it OR the shareholders are deadlocked & have failed to Elect Successors to Directors whose terms have expired
- Ordered Dissolution by the Secretary of State
 - May be done if the Corporation has FAILED to **file Required Reports** or *Tax Returns* for **2 or more years** OR the Corporation is **inactive** and dissolution is in the Public Interest
- Winding Up; After Dissolution, a Corporation REMAINS in **existence** for **3 Years**, not to do business, but to wind up its affairs. This Means:
 - *Gathering Assets, Converting them to Cash, Paying Creditors, and Distributing the Remainder to Shareholders Pro Rata* (unless Dissolution preference in Articles)

VI. SECURITIES CONSIDERATIONS (No SEC information, only MA Blue Sky)

A. Securities are Investments

- Debt: Investor lends money to the Corporation, to be REPAID, usually with interest, as specified in the Agreement.
 - *Bond*: Secured by Corporate Assets
 - *Debenture*: Unsecured
- Equity: Investor buys Stock, and has an OWNERSHIP interest in the corporation. This status carries various rights; i.e., inspect records, vote, bring derivative suits
- Convertible/Redeemable: Certain Debt Security may be convertible or redeemable in the INSTRUMENT. Equity Security may be made convertible or redeemable in the ARTICLES. Conversion gives the Security Holder the right to convert it.

B. MA Uniform Securities Act

- The MA Uniform Securities Act **Prohibits** the Following in Connection with an **Offer, Sale, or Purchase** (broader than SEC) of ANY SECURITY (≈ **10b-5**)
 - *Device or Scheme to Defraud*
 - *Material Misstatement of Fact*
 - *Omission of Fact Necessary to Make Statements not Misleading*
 - *Any ACT or PRACTICE that would Operate as a Fraud*
- **Burden of Proof on PLAINTIFF to Show FRAUD + SCIENTER** (i.e., Negligence is insufficient)

C. MA Consumer Protection Act

- The MA Consumer Protection Act **Prohibits** the Use of *unfair or deceptive practices* in ANY **business or trade**, including the Sale of Securities
- Any Stock Offering or Sale **MUST** be Accurate in ALL Material Respects (note, this Act does NOT deal with Corporate Governance)

D. Sale of a Controlling Interest

- Controlling Shareholder = Shareholder with a *Majority of the Shares Or Minority of Shares in a Situation giving her WORKING CONTROL* of the Corporation
- Usually, the Controlling Shareholder **MAY** offer to Sell her shares at a **PREMIUM**
- Traditionally, Courts have NOT Imposed a Duty on the Controlling Shareholder outside the Close Corporation. But, in **MA**, the Controlling Shareholder is under a *fiduciary limitation when selling control to a NEW GROUP*
- Note: A controlling Shareholder **CANNOT** Sell Seats on the Board. All Directors must be Elected in Compliance with the Articles of Incorporation. However, if the Controlling Shareholder sells his controlling interest and the new group wins an election to seats on the Board, that is fine.
- **A Controlling Shareholder will be LIABLE for the NEW GROUP's harm to Minority Shareholders UNLESS she made a REASONABLE INVESTIGATION into the Character & Reputation of the Buyer**
- Watch for an UNDISCLOSED Principal. An Agent approaches a Controlling shareholder and offers to purchase his interest on behalf of an UNDISCLOSED PRINCIPAL. The Controlling **MUST** Make a Reasonable Investigation into the Character & Reputation of the Undisclosed Principal or Else he will be liable for any harm to Minority Shareholders.