

1. Probably the most important, and explicit, such statute is **MBCA § § 8.60-8.63**. These sections were made part of the MBCA in 1988, replacing a much simpler single provision.
  2. Although these new sections have so far not been widely adopted by the states, they are likely to become increasingly influential
    - a. **Typical approach:** Also, the general pattern of these MBCA provisions — that a self-dealing transaction will be upheld if it is either approved by disinterested directors, ratified by shareholders or found by a court to have been fair — is typical of the approach of most states. Therefore, we consider the MBCA provisions in some detail. § § 8.60-8.63
- d. **Three-part approach: §8.61**—That section imposes two major rules:
- i. **Non-conflict transactions:** Where a transaction is “not a director’s conflicting interest transaction” (under the definitions summarized in (c) above), the court may not enjoin it or set it aside on account of any interest which the director may have in the transaction.
  - ii. **Conflict transactions:** If the transaction is a “director’s conflicting interest transaction,” the corporation and the director receive a “safe harbor” for the transaction — and the court may thus not set it aside — if: (1) a majority of disinterested directors approved it after disclosure of the conflict to them (§ 8.62); or (2) a majority of the votes held by disinterested shareholders are cast in a vote ratifying the action, after disclosure of the conflict (§ 8.63); or (3) the transaction, “judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.”
    1. **Exclusive definition of “conflicting interest”:** First, the definition of “director’s conflicting interest transaction” given in § 8.60 is exclusive. That is, if the transaction does not fall within the definition given there, the transaction is automatically deemed non-conflicting, and the court may not overturn it on grounds of director self-interest
    2. **Directors only:** Second, Subchapter F covers only transactions between the corporation and one of its directors. Transactions between the corporation and a non-director officer or shareholder are not covered by Subchapter F and are in fact not covered by any provision of the MBCA having to do with self-dealing.
      - a. Thus transactions with non-director officers or shareholders under the MBCA are left entirely to common-law principles (though the court is likely to approach these in almost the same way as a transaction between the corporation and a director).
    3. **Disclosure after controversy:** Third, the disclosure and approval can happen even after the transaction has been challenged by a dissident shareholder or third party. In other words, after-the-deal ratification by the board can suffice — pre-approval is not necessary. See Official Comment to MBCA § 8.62( a).
- e. **Three paths:** Under the MBCA and the statutes of most states, there are thus three different ways that proponents of a self-dealing transaction can avoid invalidation:
- i. [1] by showing that it was approved by a majority of disinterested directors, after full disclosure;
  - ii. [2] by showing that it was ratified by shareholders, after full disclosure; and
  - iii. [3] by showing that it was fair when made
- f. **Disclosure plus board approval:** The general principle behind the “board approval” branch is simple to state: a transaction may not be avoided by the corporation if it was authorized by a majority of the disinterested directors, after full disclosure of the nature of the conflict and the transaction. However, this formulation raises a number of questions:
- i. **What must be disclosed:** What information is it that must be disclosed to the disinterested directors? Most courts (and the MBCA) require disclosure of two major kinds of information: (1) the material facts about the conflict; and (2) the material facts about the transaction
    1. **Conflict:** Often the fact that there is a conflict will be obvious to the disinterested directors (e.g., when the contract runs directly between the director and the corporation). But other conflicts will not be obvious, and must therefore be disclosed by the Key Person. This will be true, for instance, if the other party to the transaction is a corporation in which the Key Person has a significant pecuniary interest.

1. **Generally valid:** This use of different classes and weighting of votes is generally valid. Even states that have traditionally been suspicious of attempts to re-allocate voting power by use of voting agreements and voting trusts nearly always uphold the use of classified stock for this purpose
2. **Representation for minority:** Observe that use of different classes furnishes an easy way to insure that minority gets a disproportionate (perhaps even equal) # of directors

## II. AGREEMENTS RESTRICTING THE BOARD'S DISCRETION

1. **How problem arises:** So far, we have looked only at shareholder agreements where the participants limit their discretion *as shareholders* (e.g., they agree to vote for a certain slate of directors). As we have seen, these shareholder agreements are nearly always valid. A quite different and more severe problem is posed when shareholders agree to restrict their discretion *as directors*. Such an agreement may be found to violate the principle that the business shall be managed by the board of directors; a number of cases, mostly older ones, hold that agreements that substantially fetter the discretion of the board of directors are unenforceable
  - a. **Rationale:** The courts holding that director-fettering agreements are invalid seem generally to be worried that such agreements will be unfair to minority stockholders who have not signed the agreement, and possibly to the public (including creditors)
    - i. The courts reason that the board of directors has a fiduciary obligation to the corporation, all of its shareholders and its creditors; an agreement that results in the board of directors' not being able to use its own best business judgment might result in unfair and unnecessary injury to a minority shareholder who did not agree to the restrictions on the board, or to a creditor
2. **The New York case law:** The leading line of cases limiting the enforceability of agreements that restrict the board's discretion has arisen in New York.
  - a. **McQuade:** the majority shareholder (Stoneham) and two minority shareholders (McQuade and McGraw) agreed that all would use their best efforts to keep one another in office as directors and officers at specified salaries. Subsequently, Stoneham and McGraw refused to try to keep McQuade in office as director and treasurer; after he was dropped from these positions he sued for breach
    - i. **Holding:** shareholder agreement was invalid, and thus held for the defendants.
    - ii. The court reasoned that stockholders may not, by agreeing among themselves, place "limitations ... on the power of directors to manage the business of the corporation by the selection of agents at defined salaries." In other words, the board must be left free to exercise its own business judgment
  - b. **Clark v. Dodge:** But just two years later, the New York Court of Appeals seemed to soften its prohibition of contracts that restrict the board's discretion. In Clark, P owned 25%, and D 75%, of two corporations. They signed an agreement whereby D was to vote for P as director and general manager, and to pay him one-fourth of the business' income, so long as he remained "faithful, efficient and competent." D argued that this agreement violated the McQuade rule, since it purported to restrict the discretion of the board of directors
    - i. **Holding:** But the Court of Appeals upheld this business arrangement, despite McQuade
    - ii. The court seemed to rely on two respects in which this agreement was different from the one struck down in McQuade: (1) all shareholders had signed the agreement, and there was no sign that anyone would be injured by the contract; and (2) the impairment of the board's powers was "negligible," apparently since P could always be discharged for cause, and his one-fourth of income could be calculated after the board determined in its discretion how much should be set aside for the company's operating needs.

**Synthesizing McQuade & Clark** → the law in New York seems to be that to be valid, the agreement: (1) must not harm creditors, the public or non-consenting shareholders; and (2) must involve only an "innocuous variance" from the rule that a corporation's business should be managed by the board. Also, it may be a requirement that all shareholders consent (or at the very least that the person now attacking the agreement have previously consented to it)

## II. DIRECTORS POWERS

1. Traditionally, state corporation statutes have provided that the board of directors shall “manage” the affairs of the corporation; view the board not as agents of the stockholders, but as an *independent institution* with responsibility for supervising the corporation’s affairs
  - a. **Shareholders can’t give orders:** Thus traditionally (and probably even under recently-revised statutes), the shareholders cannot order the board of directors to take any particular action. It is the board, not the shareholders, who formulate policy; shareholder control is limited to removing directors or approving/disapproving certain major actions contemplated by the board (mergers)
  - b. **Supervisory role: MBCA §8.01(b)**
    - i. Although older statutes still say that the board of directors shall “manage” the corporation, the reality is that day-to-day management is carried out by the corporation’s officers, under the supervision of the board of directors
    - ii. MODERN—MBCA says that “All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors....”
    - iii. **Sets policy:** board’s main function is to set the policies of the corporation, and to authorize the making of important contracts
  - c. **Staggered terms:** way of reducing the effect of cumulative voting, is the use of staggered terms for the board of directors. That is, the board may be divided into, say, three “classes” of directors, one class elected for a one-year term, another for a two-year term, and the last for a three-year term. Once the initial election of each class has taken place, re-election of each class is for the same term (probably for three years)—§8.06
  - d. **REMOVAL FOR CAUSE**
    - i. **MBCA § 8.09** court may order a director removed as the result of a proceeding commenced either by the corporation or by a shareholder derivative suit, if the court finds both that:
      1. the director “engaged in fraudulent conduct with respect to the corporation or its shareholders, grossly abused the position of director, or intentionally inflicted harm on the corporation,” and
      2. “removal would be in the best interest of the corporation”
2. **Quorum:** The board of directors may act only if a quorum is present
  - a. **Percentage required:** If the board has a fixed size, a quorum is a *majority of that fixed number*. This is true even though there are vacancies on the board at the moment
    - i. Example: articles of incorporation of C corporation provide that it shall have a nine-member board. At the time of a particular directors’ meeting, there are two vacancies. A quorum consists of five, not four, board members, since there must be a majority of the total number of seats, not the number of sitting directors
  - b. **Variable board: MBCA § 8.24(a)(2)**
    - i. But if the articles set up a *variable-size board*, a quorum is generally set as a majority of the directors in office at the start of the meeting
  - c. **Lesser number:** Some states, but probably still a minority, now allow the articles of incorporation or bylaws to specify a percentage that is less than a majority as the quorum
    - i. both DGCL § 141(b) and the MBCA § 8.24(b) allow the articles of incorporation or bylaws to establish any percentage that is one-third or greater as the quorum
  - d. **Super-majority as quorum: §8.24(a)**
    - i. Conversely, statutes often permit articles/bylaws to establish quorum of more than majority
    - ii. Such a provision could be used as a control device in a closely-held corporation
    - iii. For instance, the bylaws could be amended to provide that all three directors must be present for a quorum; this way, a minority shareholder who controls one seat could actively block corporate action by refusing to attend directors’ meetings
  - e. **Quorum must be present at time of vote:** The quorum must be present at the time a vote is taken in order for the vote to constitute the act of the board
    - i. Thus even if a quorum is present at the start of a meeting, directors may, by leaving, remove the quorum and thereby prevent further board action.
    - ii. (A different rule applies to shareholders’ meetings; at which all that counts is that a quorum be present at the start of the meeting)

- f. **Quorum for filling vacancies:** We said just above that the board of directors may not take action unless a quorum is present
  - i. There is one exception to this rule: In most states, the board may fill a vacancy even though less than a quorum of directors is present
  - ii. Carefully-drafted statutes make it clear that this right exists only where the number of directors in office is less than a quorum; other statutes leave open the possibility that a vacancy may be filled if less than a quorum is present at the meeting, even though more than a quorum is in office.
3. **What constitutes act of board: MBCA §8.24(c)**
  - a. board may take action only by vote of a majority of the directors present at the meeting
  - b. Higher number: modern statutes allow the articles of incorporation to specify a higher percentage than a majority for all or certain board actions. For instance, §8.24(c) allows a higher number to be required by either the articles of incorporation or the bylaws
4. **Allowed actions:** committees can take some very important actions in the name of the board, without separate board approval. For instance, a committee may authorize the corporation to take on *long-term debt* or to make a *large capital investment*; it may *set the price at which shares shall be issued* (so long as the whole board has approved the issuance); it may *appoint or remove senior management*, and *fix the salary* of these executives. **comment to § 8.25**
5. **Formalities for board action:** board of directors may take action only at a meeting, not by individual action of the directors. Directors, unlike shareholders, may not vote by proxy
  - a. Rationale: the decision-making process is likely to function better when the directors consult with and react to one another. A group discussion of problems is thought to be needed, not just a series of yea or nay responses
6. **Objection by director // Dissociate // MBCA § 8.24(d)(2) and (3)**
  - a. A director may sometimes wish to disassociate herself from action taken by the board, because she feels that the action is unwise, illegal or a breach of fiduciary duty
  - b. May be important for the director to register her dissent, because if she does not do so, she may be personally liable for the board's action even though she remained silent or orally voiced reservations
  - c. Therefore, the director in this situation should either submit a formal written dissent or abstention, or should make sure that her oral dissent or abstention is entered in the minutes of the meeting

### III. OFFICERS POWER

1. Corporation's officers serve under and at the will of the board of directors and carry out the **day-to-day** operations of the corporation. In practice, of course, the officers frequently have much greater power than this implies, especially in large publicly-held corporations
2. Important thing to remember is that, as far as most corporate statutes contemplate, the officers are essentially "**agents**" of the board of directors—major implications for the power of an officer to bind the corporation as his "principal"
3. **Not automatically binding:** an officer (even the president) will not automatically have authority to bind the corporation to a transaction merely by virtue of his office. Only if one of the 4 doctrines:
  - a. express actual authority
    - i. Explicit grant of authority to the officer to act on behalf of the corporation
    - ii. This explicit grant generally comes from either the corporation's bylaws, or in the form of a resolution adopted by the board of directors.
  - b. implied actual authority: it is often described as "authority which is inherent in the office"
    - i. **Inherent in post:**
      1. First, authority may be inherent in the particular post occupied by the officer, measured by the *common understandings of business people*
      2. I.e. president, chairman of board, VP, treasurer, secretary
    - ii. **Particular action of board:**

## SH DERIVATIVE SUITS

**"Derivative suit"** defined: A shareholder's derivative suit is a suit in which the shareholder sues "on behalf" of the corporation, on the theory that the corporation has been injured by the wrongdoing of a third person, typically an insider

1. Example: A suit brought against an officer for engaging in self-dealing transactions with the corporation.

**\*Differences:** It's important to distinguish between when a suit should be brought as a derivative suit, and when it should be brought as an ordinary "direct" suit

1. Suits for breach of the duty of care and of the duty of loyalty are normally derivative
2. Suits by a minority holder contending that the majority holder has behaved unjustly towards P (i.e. by refusing to pay dividends) are typically direct suits.
3. **Why distinguish:** The distinction between the two kinds of suits is important, because much more stringent *procedural rules* apply to *derivative* suits. (For instance, it's relatively easy for the board of directors to have the derivative suit discontinued if they don't think it has merit.)

**Demand on board:** Most states require that before derivative suit can be maintained, the plaintiff must make a "demand" on the board, in which he asks the corporation to take over the suit. If (as usually happens) board declines, court will often dismiss suit

1. **Demand excused:** But many states excuse the demand on the board in certain circumstances, such as where demand is likely to be "futile" (e.g., it's the entire board that's accused of wrongdoing, or of being under the wrongdoer's thumb).

**Settlements:** Because there's a big risk that the plaintiff and the corporation will collude, any settlement of a derivative action has to be *approved* by the court

**Indemnification:** The corporation may sometimes reimburse (indemnify) the director or officer for losses incurred relating to her actions on the corporation's behalf. In some situations, the corporation is required to indemnify, whether it wants to or not (*mandatory* indemnification) & in others, corporation may indemnify if it wishes to, but need not (*permissive* indemnification)

- I. **Remedy for Fiduciary Breaches:** wrongdoer will normally be an insider — a director, officer, or controlling shareholder — and the wrongdoer's fellow insiders will normally be reluctant to turn on one of their own
  - a. **The derivative suit:** an individual shareholder (typically an outsider) brings suit in the *name of the corporation*, against the individual wrongdoer
  - b. **Suit against insider:** The derivative suit may in theory be against *anyone who has wronged the corporation*, whether that person is an insider or outsider. Thus the defendant might be an officer who has breached the duty of due care or the duty of loyalty, or it might be an outsider who has *injured the corporation* in some other way (i.e. by breaching a contract with it, by committing a tort against it, etc.)
    - i. But because the corporation itself, by vote of its board of directors, will usually not have any special reluctance to pursue claims against outsiders, the particular utility of the derivative suit is to pursue claims on the corporation's behalf against insiders
    - ii. **Breach of loyalty:** Most significantly, claims can be brought against an insider who has caused the corporation to enter into a self-dealing transaction with him (e.g., a sale of corporate property at below fair market value) or against an insider who has usurped a corporate opportunity
    - iii. **Breach of due care:** typically, with less success, based on the insider's alleged violation of his duty of due care. For instance, if Corporation's board of directors vote to acquire all of the stock of Small Corp., and the acquisition turns out to be disastrous, a shareholder might bring a derivative action against the individual directors who approved the transaction, alleging that they failed to use due care in making the acquisition
- c. **PROS, FAVORING DETRIVATIVES:** those who find a lot of value in derivative suits, and who therefore argue for court rules that make it relatively easy to file and pursue such suits, make the following arguments:
  - i. **Remedy for insider wrongdoing:** Such suits are practically the only effective remedy when insider wrongdoing occurs. The corporation itself (as represented by its incumbent board of directors) will rarely take action against an insider. The discipline of the marketplace (e.g., a decline in the market price of the company's stock when insiders are wronging the corporation) does little to deter wrongdoing, especially among insiders who own very little of the company's stock. Only an action brought by a shareholder whose investment has been made less valuable because of the wrongdoing will directly redress the injury to the corporation

- c. **Illustration of direct actions:** by contrast, are some of the types of suits that are generally held to be direct:
- i. Voting: An action to enforce the holder's voting rights, or to prevent some other shareholder from improperly voting his shares;
  - ii. Dividends: An action to compel the payment of dividends;
  - c. Anti-takeover defenses: An action to prevent management from improperly using the corporate machinery to entrench itself (e.g., a suit to enjoin the corporation from enacting a "poison pill" which would prevent a takeover);
  - iii. Inspection: An action to compel the inspection of the corporation's books and records
  - iv. Protection of minority shareholders: A suit to prevent oppression of, or fraud on, minority shareholders, especially where the corporation is closely-held
- d. **\*DIRECT IS PREFERRED**—Consequences of distinction → WHY?
- i. **Procedural requirements**: If the action is derivative, the plaintiff must jump through a number of procedural hoops merely to be able to proceed at all. For instance, he must satisfy the "contemporaneous ownership" rule, by which he must have been a shareholder at the time the wrong complained of occurred; similarly, he may have to comply w/ a security-for-expenses statute.
    1. **No jury trial**: Plaintiff in a derivative action also will typically face trial rules that are less favorable to him than he would in a direct action. For instance, most states hold that a derivative action is equitable, and that there is therefore no right to a jury trial on it.
  - ii. **Demand on board; termination**: Second, P in a derivative suit is much more likely to *lose control of his action* than where the action is direct. For instance, the plaintiff must generally make a demand on the board of directors that it bring suit; the board of directors (or, increasingly, a special committee appointed by the board) may in most states investigate and recommend termination of the suit. The court will often respect this termination recommendation, so that the plaintiff will simply not be allowed to proceed. In a direct action, by contrast, the plaintiff (or the plaintiff class) will get to proceed unless D obtains a summary judgment, a much more difficult thing to get.
  - iii. **Who gets recovery**: distribution of the recovery is likely to be more attractive to the plaintiff in a direct than in a derivative suit
    1. Derivative—the recovery is always by the corporation, and the plaintiff benefits *only to the extent that his shares in the corporation* (as well as the shares of everyone else) become more valuable due to the corporation's recovery
    2. Direct—P may be able to put money directly into his own pocket. For instance, if P sues to compel the payment of a dividend, this money will be paid directly to him if he succeeds

III. **Requirements for Maintaining Derivative**: generally: There are three main procedural requirements that, in most states, a plaintiff must meet in order to maintain a derivative suit:

- a. **Contemporaneous Ownership Rule**: P must have been a shareholder at the time of the acts complained of)
  - i. **Nearly universal requirement**: **MBCA § 7.41** (the shareholder may not commence or maintain a derivative proceeding unless she "was a shareholder of the corporation at the time of the act or omission complained of....")
  - ii. **Rationale**: Two reasons are usually given for the contemporaneous ownership rule:
    1. (1) it discourages litigious people from bringing frivolous suits, since they can't look around for wrongdoing and then buy shares that will support standing; and
    2. (2) a person who buys after the wrong with knowledge of it may pay a lesser price, and would thus receive a windfall if he obtains a corporate recovery
  - iii. **Criticism**: on the grounds that it *screens out meritorious suits* as well as frivolous ones, and screens out suits where there would be no unjust enrichment
- b. **Continuing Ownership Rule**: P must still be a shareholder at the time of the suit; and
  - i. I.e. continue to own the shares in the corporation not only at the time of suit, but right up until the moment of judgment. In other words, P must continue to have an actual (even if tiny) economic stake in the outcome of the suit right until its conclusion
  - ii. **Involuntary merger**: Normally, this requirement does not have much bite — since even a one-share holding by the plaintiff will suffice, compliance with the requirement is rarely difficult for the plaintiff. But there is one situation in which the continuing-ownership rule does have real bite: the situation in which all shares in the corporation are involuntarily exchanged into cash or shares in a different corporation, as part of a merger transaction. Here, many courts ease the unfairness that

## Business Enterprise Outline

### I. The Law of Agency

#### a. Defining the Agency Relationship

- i. An agent can bind his or her principal to a contract, subject that principal to tort liability, and, in some circumstances, to criminal liability

#### ii. Agency Relationship: defined in **RST 2<sup>nd</sup> § 1(1)**

1. **Fiduciary relationship §13, 14, 18**; that arises when one person (a “principal”) manifests assent to another person (the “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act

##### a. (1) **Manifestation of consent §15**; and

- i. conscious, contract (should be written, doesn’t have to be)
- ii. P → want A to act; some manifestation must reach A
- iii. A → consenting to acting on P’s behalf; must have legal capacity
- iv. Irrelevant if P unaware relationship formed
- v. **Objective standard**: outward manifestations & reasonable person
  1. Whether would-be A would reasonably interpret P has done to be consent?
  2. Court looks to conduct, words, silence (implied; i.e. start task)

##### b. (2) **Control §14**

- i. Must be a “continuous control of P”
- ii. Must include an understanding that P is in control of relationship
- iii. A can bind P, A should not be a risk-taker
  1. A is not P’s partner = does not receive a profit
  2. A made whole [indemnified] from P for any losses
  3. Compensation = reasonable

#### 2. **Agency v. Contract**

- a. Essentially, agency is consensual relationship in which one agrees to act for benefit of other

##### b. **ISSUES that arise in the cases:**

- i. (1) Is there an agency relationship?
- ii. (2) If so, does the agent have authority to bind the principal?

##### c. The Agency Relationship is typically a contractual relationship

- i. But contract is *not necessary* to have an agency relationship
- ii. You do, however, need a consensual relationship
- iii. Legally bilateral relationship (P-A); reciprocal duties
- iv. Practically unilateral relationship (P-A-3P)
- v. Triggers direct legal relationship between P and 3P
- vi. Cannot compete with P—need to disclose key info that will effect decisions, obey P

#### iii. **Employment relationship**

1. This is the most common principal-agent relationship
2. In the typical relationship, P will hire or retain A to perform some service

#### **THAYER v. PACIFIC ELECTRIC RAILWAY**

(1961)—Purchased precision grinding machine, Illinois shipped to CA, notified arrived, machinery movers come to remove it, before moving equipment see it is damaged

##### **ISSUE:**

Whether the Plaintiff complied with the requirement of the bill of lading that in order to recover for damages to freight, a claim in writing must be filed with the carrier within 9 months after delivery of the property.

##### **RULE:**

**The existence of an agency relationship is a question of fact which can be inferred from the conduct of the parties**

##### **HOLDING:**

The notice requirement does not require documents in any particular form, and therefore, the annotated freight bill *could* qualify as notice. The fact that the freight bill was annotated by Hileman, Pacific’s agent, is not fatal to Thayer’s claim. He signed the bill at Thayer’s insistence, and thus even though Pacific’s agent, he was Thayer’s agent for the purpose of annotating the freight bill. **Affirmed.**

#### iv. **Fiduciary:** In general, a fiduciary owes to the person for whom he is a fiduciary (the “beneficiary”) certain duties

1. Adjusts certainty of risk/costs through special responsibilities
2. Relationship of trust & confidence; power to bind—agent needs to act to benefit P
3. **Fiduciary Duties:** Consist of duty on the part of the fiduciary to discharge his duties with care and with loyalty to the beneficiary; imply an ongoing relationship, as opposed to an *agency relationship*, which may be limited to a single act (see *Thayer*)
  - a. A cannot delegate to another party without permission of P or benefactor
  - b. A must obey P. even if disagree

Whether Cargill, by its course of dealing with Warren, became liable as a principal on contracts made by Warren with plaintiffs.

#### RULES:

1. An agreement may result in the creation of an agency relationship although the parties did not call it an agency and did not intend the legal consequences of the relation to follow. The existence of an agency may be proved by *circumstantial* evidence which shows a course of dealing between the two parties
2. A creditor who assumes control of his debtor's business may become liable as principal for the acts of the debtor in connection with the business (**Rst. 2<sup>nd</sup> of Agency § 14 O**).  
**Defacto Control:** presumes liability, day-to-day operations
3. One who contracts to acquire property from a 3P and convey it to another is the *agent* of the other only if it is agreed that he is to act primarily for the benefit of the other and not for himself

#### HOLDING:

Cargill was P over Warren and is therefore liable for the damages sustained by Plaintiffs. Cargill consented to be a principal once Warren agreed to implement the changes and policies that Cargill suggested. Cargill's subsequent interference in Warren's internal operations further established the relationship. Cargill argued that they never consented to the agency relationship, and each of their actions could fall under a debtor-creditor or a buyer-seller relationship. Alternatively, Cargill argues that it is at best an undisclosed principal because they settled with the agent and no third parties entered directly into a contract with them. The court agrees that many of the factors, when taken individually, could fall into another category of a relationship. But the factors need be taken as a whole.

#### b. Contractual Powers of Agent

##### i. Two sources of an agent's authority recognized by courts:

##### 1. (1) **Actual Authority** → *expressions made to the agent by the principal delineating the agent's authority*

- a. Authority arises from the manifestations of a consenting P to an A, that the A has power to deal with others as a representative of P, and A believing actions will bind P.
- b. **STANDARD:** A's belief be reasonably objective, but A actually holds subjective belief
- c. Some task in which A connects the P with the 3P
- d. Focus on relationship btw A & P—knowledge of P is irrelevant
- e. Written document (K) between P and A, in corporate bylaws, or in a written power of attorney
  - i. **NOTE:** A writing is *not necessary*; a principal can orally tell the agent what authority the agent has to bind the principal
  - ii. In question → look primarily at A and their manifestations

##### f. **Implied Authority**

- i. Authority may be inferred from a prior course of conduct by the P
- ii. Such conduct may be the basis for implying that A has a continuing actual authority to act on P's behalf—shown circumstantially
  1. **§ 35 cmt. (b)** P forgets to act = implied authority fills in gaps
  2. Ex. If P authorizes an A to borrow money on its behalf, the A's authority to execute a promissory note may be implied

##### g. **Incidental / Expressed Authority § 35**

1. Unless otherwise agreed, authority to do acts which are incidental to others, usually accompany it, or are reasonable necessary to accomplish it
2. Implications based on custom or past dealings

##### h. **Inherent Authority**

- i. Doctrine imposes *enterprise liability*, loss on enterprise that benefits relationship
- ii. P entrusts A with ongoing responsibilities → general agent
- iii. Notion of enterprise & custom [inherent = thus in relationship]
  1. **§ 8A:** derived solely from agency relation and exists for the protection of persons harmed by or dealing with servant or other agent
  2. In practice, inherent authority is indistinguishable from *apparent authority*
  3. **NOTE:** Rest. 3<sup>rd</sup> of Agency has abandoned the term "inherent" authority
- iv. **2-policy based limitations**
  1. 3P knows A is acting without authority; or
  2. A is not acting in P's interests

##### 2. (2) **Apparent Authority**

- a. Agent (apparent P) makes a manifestation that somehow reaches a 3P & in context of other circumstances causes 3P to reasonably believe vested authorized to act for P—**§ 8**
- b. Focuses on P → TP, need some type of manifestations from P to 3P
- c. **Reasonableness standard:** mere belief not sufficient
  - i. Must be able to point to some manifestation attributable to P. *\*relies to their detriment*

|                                                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Sole Proprietorship</b></p>                          | <p><b>Rights:</b> Will personally recognize the income or loss of the business on <u>personal income tax return</u></p> <p><b>Financing:</b> Business may be financed out of personal account, which commingles business with personal finances (i.e., no legal requirement to separate books and records, although may wish to do so to determine how the business is doing)</p> <p><b>Frequency:</b> There are more than 20 million sole proprietorships in the United States</p>                                                                                                                                                                                                                                                                                                                                                                                                   |
| <p><b>General Partnership</b></p>                          | <p><b>**THIS IS THE DEFAULT ENTITY IN THE LAW**</b></p> <p><b>Definition:</b> When two or more entrepreneurs join together to operate a business, they have wittingly, or unwittingly, formed a general partnership. (NOTE: there is no need to file any document with the state to formalize or legitimize their undertaking)</p> <p><b>Obligations:</b> Each partner is <i>jointly and severally liable</i> for all debts, including tort liability, of the business and each will be an agent for the other, will full agency authority to bind one another on obligations of the business. This can be altered by <i>agreement</i>, but absent agreement, the common law and, (today) partnership statutes, provide these default rules.</p> <p><b>Rights:</b> Partners will recognize a pro rata share of the business's income or loss on their personal income tax returns</p> |
| <p><b>Limited Liability Partnership (LLP)</b></p>          | <p><b>Definition:</b> A general partnership with an important modification: the partners are <i>not personally liable for all debts and obligations except to the extent they have agreed to be</i> (for contractual obligations or for personal fault (for tort obligations))</p> <p><b>Creation:</b> To obtain advantages of limited liability, partnership must file a document with the designated state office</p> <p><b>Obligations:</b> Partners are liable for all debts and obligations to the extent that they have agreed to be (for contractual obligations) or to the extent that they bear personal fault (for tort obligations)</p>                                                                                                                                                                                                                                    |
| <p><b>Limited Partnership (LP)</b></p>                     | <p><b>Definition:</b> In its simplest form, a LP has two classes of partners: (1) general, and (2) limited.</p> <p><b>General Partners</b> in a LP are like general partners in a conventional partnership (i.e., have personal liability for the debts of the business).</p> <p><b>Limited Partners</b> (by statute) are not liable for debts of the business, although care must be exercised in some states about their participation in control. They do not have agency authority as limited partners, although they can contract otherwise.</p> <p>For federal income tax purposes, limited and general partners are not liable for the debts of the business, although care must be exercised in some states about their participation and control.</p> <p><b>Creation:</b> Created only when a document is filed with a designated office in the state</p>                    |
| <p><b>Limited Liability Limited Partnership (LLLP)</b></p> | <p><b>Definition:</b> A LLLP is a limited partnership in which the general partner(s) has limited liability, akin to the liability of a partner in an LLP.</p> <p><b>Creation:</b> To secure this limited liability, the partnership must file an election in a designated office in the state.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|                                                            | <p><b>Definition:</b> A LLC is the <i>newest</i> option for an entrepreneur, offering the benefits of limited liability, taxation as a partnership, and management flexibility; It is possible to have a one-person LLC</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |

Rouse was referred to Fitz to be her attorney in separation agreement, he talked her into selling him her securities, essentially embezzled her funds; claiming he was acting in his authority of law firm

**NOTE:** Fitzsimmons membership in the Riker firm did not, alone, per se create liability by his partners for his acts outside the general scope of the practice of law. Court held not acting as authority w/ firm

**HOLDING/REASONING:**

**Key to this case:** When Rouse went to Riker and Riker in *reliance upon their reputation as a law firm*, stated the purpose of her visit (to obtain legal service), and was introduced to Fitzsimmons as a member of the firm who would provide the desired service, she had no justification therein for relying upon the responsibility of the partnership for any *disconnected services* assumed by Fitzsimmons outside one that was characteristically within the practice of law

- (1) That the investment of the funds in mortgages was within the scope of the defendant law firm's practice; or
- (2) within the scope of Fitzsimmons' apparent authority

- NOT a characteristic function of practice of law to accept clients' money for deposit and future investment in unspecified securities at the discretion of the attorney
- Has not been done by attorneys with such frequency or appropriateness as to become a phase of the practice
- The law firm did nothing to indicate that Fitzsimmons had any authority to act in their behalf ***outside the practice of law***

**b. Rights and Duties Among Partners**

**(1) DUTY OF CARE**

**d. Business Judgment Rule**

- i. When a partner alleges another has violated his fiduciary duty, the allegedly violating partner must show he acted:

- 1. (1) in good faith;
- 2. (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
- 3. (3) in a manner the partner reasonably believes to be in the best interests of the partnership

- a. However, the rule will *not* apply if the partners have engaged in *self-dealing, fraud, or other unconscionable conduct*

- i. If the business judgment rule applies, court typically will not further review the decision in question
- ii. If BJR does not apply → BOP shifts to partner who made decision to demonstrate it was fair to partners
- iii. Failing a showing that it was fair, the decision maker is liable for damages resulting from the decision made

**e. UPA and RUPA**

- i. UPA does not specifically address the duty of care partners owe each other

- 1. It specifies that, subject to contrary agreement, **losses** are shared according to the sharing of **profits**

- ii. RUPA § 404(c) directly addresses a partner's standard of care:

- 1. "A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law"

- 2. **STANDARD:** gross negligence

- a. A paid agent is subject to a duty to the principal to act with the standard of care and skill accepted in the locality for the kind of work involved and, in addition, to exercise any special skills the agent has or purports to have

- i. This standard does not apply to partners

- ii. RUPA declined to create a special default rule for losses caused by the *negligence of partners*

- iii. Partners in better position than ordinary principal to watch out, supervise, and when necessary, intervene

- iv. Instead, such losses are treated in the same way as losses caused by the negligence of a non-partner agent

**v. Joint Venture Partner**

- 3. May NOT maintain negligence against another partner if:

- a. Committed w/in scope of joint business venture
- b. Was not result of bad faith

**Under RUPA §404(a)**

The only fiduciary duties a partner owes to GP & other partners are the duty of loyalty & duty of care set forth in (b) & (c)

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## f. Dissociation and Dissolution

1. Dissociation—separation of partner from partnership
2. Dissolution—point @ which partnership stops function as forward-looking enterprise & begins to wind up its business
3. **Dissolution under UPA and RUPA**
  - a. In the area of *DISSOLUTION*, RUPA implemented an important change in the law:
    - i. Under **UPA**, any time a partner left the partnership, for whatever reason, the partnership “dissolved.”
      1. Unless the parties had an agreement that entitled the remaining partners to continue the business, the partnership was required to liquidate, discharge its debts, and distribute any remaining proceeds to the partners
      2. **RESULT:**
        - a. Partnerships were unstable as a business entity
        - b. The underlying philosophy of the UPA was that partnerships were not separate legal entities but, rather an aggregate of individuals
    - ii. **RUPA** clearly declared that a partnership is an entity in **RUPA § 201**
      1. The departure of a partner under RUPA did *not* dissolve the partnership
      2. except under certain limited circumstances
        - a. Rather, the departing partner is characterized as having “dissociated” from the partnership and the partnership continues without him
        - b. **BC IT IS AN ENTITY**
      3. **RUPA § 601** lists 10 events that will cause dissociation (see SS page 286-287) OR page 411 in E&E
      4. Many dissociations result in a *buyout* of the dissociating partner’s interest under **RUPA Article 7** (See SS pg 295)
      5. The dissolution provisions of RUPA are contained in **§ 801**
        - a. They are *largely buyout in nature*; can sever in PA
          - i. With several narrow exceptions, they are not included in the list of mandatory terms in **§103**
          - ii. Thus, similar to UPA, partners under RUPA have the contractual freedom to avoid termination of the business
          - iii. However, *unlike* under UPA, partners under RUPA can simply deny the event of dissolution
          - iv. **NOTE:** The result is typically the same under RUPA and UPA: the business continues + departing partner is paid out

**\*\*Most should be dealt w/ in partnership agrmt**

**\*\*Generally know how scheme works for a partner to get out**

### b. Two Avenues for Dissociation

“Switching provision”—if partner’s dissociation results in dissolution, the switch activates Article 8 (wind up); and IF NOT = Art. 7 (buy-out)

#### i. Continuance-Buy-Out: **RUPA §701-04—NO DISSOLUTION**

1. Continuance of partnership by other partners; §701
2. If you continue, there has to be a **buyout**
  - a. this is a statutory scheme
  - b. have in partnership agreement the details of any buyout
  - c. Cannot vary power to dissociate BUT **can vary buyout provisions**
3. **§702(a)**—dissociated partner’s lingering power to bind
4. **§704(a)**—public filings of statement of dissociation
  - a. stating the name of partnership & partner dissociated w/ firm
  - b. gives constructive notice, loses all authority
5. **RATIONALE:** partnership is an ongoing business and if just had to liquidate it anytime the partner wanted to get out, that may not be desirable
  - c. At the same time, you have to give an opportunity to get out
  - d. There are a set of provisions under **§7** dealing with the dissociating partners’ interests and the liability of the dissociating partner(s); or under **§8** there are provisions for winding up (a process that goes beyond the dissociation of a partner; where you are actually going to liquidate and terminate)

#### i. Winding Up/Termination/Settlement: **RUPA §801-07**

1. **§801:** mandatory dissolution—conditions that must be proven
2. preserve partnership business or property as going concern for reasonable time
3. prosecute & defend actions & proceedings