CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS

STATUTES, RULES, AND FORMS

2015 EDITION

Douglas K. Moll

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2015 Edition

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常州大学山书馆
藏书章

WEST ACADEMIC PUBLISHING

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444 Cedar Street, Suite 700
St. Paul, MN 55101
1-877-888-1330

Printed in the United States of America

ISBN: 978-1-63459-611-4

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PREFACE

First, a hearty thanks to Professor Jeffrey Bauman for all of his hard work on prior editions. This edition largely follows the template that he left behind.

Second, I received invaluable help from Daniel Donahue of the O'Quinn Law Library at the University of Houston Law Center. Daniel was of great assistance in updating and editing many of these materials.

Finally, I welcome any comments or suggestions for additions (or deletions) to these materials. I can be reached via email at dmoll@central.uh.edu.

DOUGLAS K. MOLL

July 2015

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TOPIC 1. DEFINITIONS

§ 1. Agency; Principal; Agent

(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.

(2) The one for whom action is to be taken is the principal.

(3) The one who is to act is the agent.

Comment b. Agency a legal concept. Agency is a legal concept which depends upon the existence of required factual elements: the manifestation by the principal that the agent shall act for him, the agent's acceptance of the undertaking and the understanding of the parties that the principal is to be in control of the undertaking. The relation which the law calls agency does not depend upon the intent of the parties to create it, nor their belief that they have done so. To constitute the relation, there must be an agreement, but not necessarily a contract, between the parties; if the agreement results in the factual relation between them to which are attached the legal consequences of agency, an agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow. Thus, when one who asks a friend to do a slight service for him, such as to return for credit goods recently purchased from a store, neither one may have any realization that they are creating an agency relation or be aware of the legal obligations which would result from performance of the service. On the other hand, one may believe that he has created an agency when in fact the relation is that of seller and buyer. *See* § 14J. The distinction between agency and other relations, such as those of trust, buyer and seller, and others are stated in Sections 14A to 14O. The distinction between the kind of agent called a servant and a non-servant agent is stated in Section 2.

When it is doubtful whether a representative is the agent of one or the other of two contracting parties, the function of the court is to ascertain the factual relation of the parties to each other and in so doing can properly disregard a statement in the agreement that the agent is to be the agent of one rather than of the other, or a statement by the parties as to the legal relations which are thereby created. *See* § 14L. The agency relation results if, but only if, there is an understanding between the parties which, as interpreted by the court, creates a fiduciary relation in which the fiduciary is subject to the directions of the one on whose account he acts. It is the element of continuous subjection to the will of the principal which distinguishes the agent from other fiduciaries and the agency agreement from other agreements. The characteristics which tend to indicate an agency or a non-agency relation are stated in Sections 12 to 14O.

§ 2. Master; Servant; Independent Contractor

(1) A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.

(2) A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master.

(3) An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking. He may or may not be an agent.

Comment a. Servants and non-servant agents. A master is a species of principal, and a servant is a species of agent. The words "master" and "servant" are herein used to indicate the relation from which arises both the liability of an employer for the physical harm caused to third persons by the tort of an employee (*see* §§ 219–249) and the special duties and immunities of an employer to the employee. *See* §§ 473–528. Although for brevity the definitions in this Section refer only to the control or right to control the physical conduct of the servant, there are many factors which are considered by the courts in defining the relation. These factors which distinguish a servant from an independent contractor are stated in Section 220. The distinction between servants and agents who are not servants is of importance for the purposes of the Sections referred to. Statements made in the Restatement of this Subject as applicable to principals or agents are, unless otherwise stated, applicable to masters and servants. The rules as to liability of a principal for the torts of agents who are not servants are stated in Sections 250–267, and those with respect to his liability in tort to such agents in Sections 470–472. The duties of servants to masters and their liabilities to third persons are in general the same as those of agents who are not servants. However, servants may have only custody, as distinguished from possession of goods entrusted to them by the master (*see* § 339, Comment *g* and § 349), and a servant, because of his position, may not be responsible for mistakes made by him as to facts upon which his authority depends, whereas an agent who is not a servant would be responsible. *See* Comment *c* on § 383.

§ 3. General Agent; Special Agent

(1) A general agent is an agent authorized to conduct a series of transactions involving a continuity of service.

(2) A special agent is an agent authorized to conduct a single transaction or a series of transactions not involving continuity of service.

§ 4. Disclosed Principal; Partially Disclosed Principal; Undisclosed Principal

(1) If, at the time of a transaction conducted by an agent, the other party thereto has notice that the agent is acting for a principal and of the principal's identity, the principal is a disclosed principal.

(2) If the other party has notice that the agent is or may be acting for a principal but has no notice of the principal's identity, the principal for whom the agent is acting is a partially disclosed principal.

(3) If the other party has no notice that the agent is acting for a principal, the one for whom he acts is an undisclosed principal.

§ 7. Authority

Authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him.

§ 8. Apparent Authority

Apparent authority is the power to affect the legal relations of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestations to such third persons.

§ 8A. Inherent Agency Power

Inherent agency power is a term used in the restatement of this subject to indicate the power of an agent which is derived not from authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent.

§ 8B. Estoppel; Change of Position

(1) A person who is not otherwise liable as a party to a transaction purported to be done on his account, is nevertheless subject to liability to persons who have changed their positions because of their belief that the transaction was entered into by or for him, if

(a) he intentionally or carelessly caused such belief, or

(b) knowing of such belief and that others might change their positions because of it, he did not take reasonable steps to notify them of the facts.

(2) An owner of property who represents to third persons that another is the owner of the property or who permits the other so to represent, or who realizes that third persons believe that another is the owner of the property, and that he could easily inform the third persons of the facts, is subject to the loss of the property if the other disposes of it to third persons who, in ignorance of the facts, purchase the property or otherwise change their position with reference to it.

(3) Change of position, as the phrase is used in the restatement of this subject, indicates payment of money, expenditure of labor, suffering a loss or subjection to legal liability.

TOPIC 2. KNOWLEDGE AND NOTICE

§ 9. Notice

(1) A person has notice of a fact if he knows the fact, has reason to know it, should know it, or has been given notification of it.

(2) A person is given notification of a fact by another if the latter

(a) informs him of the fact by adequate or specified means or of other facts from which he has reason to know or should know the facts: or

(b) does an act which, under the rules applicable to the transaction, has the same effect on the legal relations of the parties as the acquisition of knowledge or reason to know.

(3) A person has notice of a fact if his agent has knowledge of the fact, reason to know it or should know it, or has been given a notification of it, under circumstances coming within the rules applying to the liability of a principal because of notice to his agent.

Comment d. Reason to know. A person has reason to know of a fact if he has information from which a person of ordinary intelligence, or of the superior intelligence which such person may have, would infer that the fact in question exists or that there is such a substantial chance of its existence that, if exercising reasonable care with reference to the matter in question, his action would be predicated upon the assumption of its possible existence. The inference drawn need not be that the fact exists; it is sufficient that the likelihood of its existence is so great that a person of ordinary intelligence, or of the superior intelligence which the person in question has, would, if exercising ordinary prudence under the circumstances, govern his conduct as if the fact existed, until he could ascertain its existence or non-existence. The words "reason to know" do not necessarily import the existence of a duty to others to ascertain facts; the words are used both where the actor has a duty to another and where he would not be acting adequately in the protection of his own interests were he not to act with reference to the facts which he has reason to know. One may have reason to know a fact although he does not make the inference of its existence which would be made by a reasonable person in his position and with his knowledge, whether his failure to make such inference is due to inferior intelligence or to a failure properly to exercise such intelligence as he has. A person of superior intelligence or training has reason to know a fact if a person with his mental capacity and attainments would draw such an inference from the facts known to him. On the other hand, "reason to know" imports no duty to ascertain facts not to be deduced as inferences from facts already known; one has reason to know a fact only if a reasonable person in his position would infer such fact from other facts already known to him.

Further, a person has reason to know facts only if the circumstances are such that any unconscious knowledge would be made conscious if such person were to meet the required standards with reference to memory, consideration for the interests of others, or, in some instances, consideration for one's own interests. Thus, one who had no reason to remember facts once known would not at a later time have reason to know the facts. *See* Sections 276 and 277, which deal with situations in which this distinction may be crucial in determining the liability of the principal because of what an agent has reason to know.

TOPIC 3. ESSENTIAL CHARACTERISTICS OF RELATION

§ 13. Agent as a Fiduciary

An agent is a fiduciary with respect to matters within the scope of his agency.

§ 14. Control by Principal

A principal has the right to control the conduct of the agent with respect to matters entrusted to him.

Comment a. The right of control by the principal may be exercised by prescribing what the agent shall or shall not do before the agent acts, or at the time when he acts, or at both times. The principal's right to control is continuous and continues as long as the agency relation exists, even though the principal agreed that he would not exercise it. Thus, the agent is subject to a duty not to act contrary to the principal's directions, although the principal has agreed not to give such directions. *See* § 33. Further, the principal has power to revoke the agent's authority, although this would constitute a breach of his contract with him. *See* § 118. The agent cannot obtain specific performance of the principal's agreement. If the agent has notice of facts from which he should infer that the principal does not wish him to act as originally specified, the agent's authority is terminated, suspended, or modified accordingly. *See* § 108. The control of the principal does not, however, include control at every moment; its exercise may be very attenuated and, as where the principal is physically absent, may be ineffective.

The extent of the right to control the physical acts of the agent is an important factor in determining whether or not a master-servant relation between them exists. *See* § 220.

Comment b. If it is otherwise clear that there is an agency relation, as in the case of recognized agents such as attorneys at law, factors, or auctioneers, the principal, although he has contracted with the agent not to exercise control and to permit the agent the free exercise of his discretion, nevertheless has power to give lawful directions which the agent is under a duty to obey if he continues to act as such. *See* § 385. If the existence of an agency relation is not otherwise clearly shown, as where the issue is whether a trust or an agency has been created, the fact that it is understood that the person acting is not to be subject to the control of the other as to the manner of performance determines that the relation is not that of agency. *See* § 14B.

TOPIC 4. AGENCY DISTINGUISHED FROM OTHER RELATIONS

§ 14H. Agents or Holders of a Power Given for Their Benefit

One who holds a power created in the form of an agency authority, but given for the benefit of the power holder or of a third person, is not an agent of the one creating the power.

§ 14O. Security Holder Becoming a Principal

A creditor who assumes control of his debtor's business for the mutual benefit of himself and his debtor, may become a principal, with liability for the acts and transactions of the debtor in connection with the business.

Comment a. A security holder who merely exercises a veto power over the business acts of his debtor by preventing purchases or sales above specified amounts does not thereby become a principal. However, if he takes over the management of the debtor's business either in person or through an agent, and directs what contracts may or may not be made, he becomes a principal, liable as any principal for the obligations incurred thereafter in the normal course of business by the debtor who has now become his general agent. The point at which the creditor becomes a principal is that at which he assumes de facto control over the conduct of his debtor, whatever the terms of the formal contract with his debtor may be.

Where there is an assignment for the benefit of creditors, the latter may become the principals of the assignee if they exercise control over transactions entered into by him on their behalf.

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