

Corporations

Third Edition

Lewis D. Solomon
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EXAMPLES & EXPLANATIONS



ASPEN LAW & BUSINESS

CORPORATIONS

Examples and Explanations
Third Edition

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Preface

For many students corporate law is a cold, uninviting mystery. Notions such as debt/equity ratios, proxy solicitations, stock markets, leveraged buyouts, and cumulative preferred stock cause many to freeze. Besides its unfamiliar business setting, corporate law draws from a jumble of topics and analytical techniques. It mixes civil procedure, contracts and agency rules, tort concepts, some constitutional and property principles, and even criminal law. Statutory interpretation combines with case synthesis and regulatory analysis, all flavored with policy debates. Adding to the conceptual challenge, some corporations casebooks are organized according to a theoretical corporate life-cycle — beginning with incorporation, then continuing through the corporation's early formative phase, its period of business activity, and finally its cataclysmic acquisition or dissolution.

But corporate law is actually more coherent. Viewing the corporation as an investment vehicle that pools money and labor, corporate law seeks to resolve the conflicts among money contributors (shareholders and creditors) and labor contributors (management). *Corporations: Examples and Explanations* presents you with a full and clear understanding of each set of legal protections that address the conflicts among corporate participants. We have organized these basic sets of legal protections into eight parts:

- **Part I — Overview.** We introduce the history and attributes of the U.S. corporation and describe other non-corporate forms of business organization — such as partnerships, limited partnerships, and limited liability companies.
- **Part II — Formation of the Corporation.** We explain the incorporation process, the issuance of shares, the relation of debt and equity, and the information rights of investors who buy securities.
- **Part III — Shareholder Voting Rights.** We give an overview of the governance of corporations with publicly traded shares and describe the state statutory rules and judicial protection of the voting process, as well as the federal disclosure and antifraud regime that applies to voting in public corporations.
- **Part IV — Corporate Fiduciary Duties.** We consider when judges intervene in management decisions and when they defer to business judgment, and look at specific corporate activities: self-dealing transactions, executive compensation, indemnification, corporate opportunities,

parent-subsidary dealings. We also consider the procedures by which fiduciary duties are enforced.

- **Part V — Shareholder Liquidity Rights.** We describe the shareholders' right to freely transfer their shares and consider protections for this right (such as disclosure in securities trading markets) and limits on free transferability (such as insider trading restrictions).
- **Part VI — Closely Held Corporations.** We discuss the dilemma of close corporations, which lack a market for their shares. We describe the special contractual arrangements and sometimes judicial intervention that substitute for stock markets.
- **Part VII — Protections for Corporate Creditors.** We explain the rule of limited liability and its allocation of risks between corporate insiders and outside creditors. We describe how limited liability arises during the incorporation process, when the corporation can be bound in dealings with outsiders, and how insiders are constrained in corporate dealings that affect outside creditors.
- **Part VIII — Corporate Fundamental Changes.** We consider how the various corporate rights and duties can be changed and describe (and illustrate) the mechanics of corporate restructurings, mergers, sales of assets, and tender offers, as well as the various protections for shareholders. We discuss federal regulation of takeovers and state regulation of takeover defenses.

As you can see, *Corporations: Examples and Explanations* is meant to illuminate the essential building blocks of the corporation — that is, the basic rights and duties of corporate constituents. We have strived to make this book accessible to students who possess no background in business. The book also gives you an opportunity to probe and test your understanding of these legal concepts. The textual discussion provides a framework for your understanding, and the follow-up examples and explanations reinforce and illuminate the text. You will find that reading the relevant chapter and writing out answers to the examples, before comparing them to ours, will go a long way in helping you prepare for class and the exam. And beyond.

Acknowledgments

We have greatly appreciated the curiosity and insights of our students. Their questions and comments, in and out of class, inspired much of this book.

We owe special thanks to a cadre of Wake Forest law students whose research and editorial suggestions on this third edition were invaluable — in particular Chris Leggett ('99), Dan Quesnel ('99), and Brooks Casey ('00).

Finally, we thank the many professors who have suggested our book to their students, and for their many helpful comments and kind words of encouragement.

Special Notice

To reduce the distraction of citations, this book departs from standard citation form:

1. **Dates.** References to statutory sources and SEC rules are usually undated. All such references are to compilations as of 1998, unless we give a different date.

2. **State statutes.** We abbreviate the citations to corporation statutes:

MBCA §8.50	Model Business Corporation Act, Section 8.50 (as approved in 1984, with revisions through 1998)
Cal. Corp. §317	California Corporations Code, Section 317
Del. GCL §145	Delaware General Corporation Law, Section 145
N.Y. BCL §721	New York Business Corporation Law, Section 721

The American Law Institute's "Principles of Corporate Governance: Analysis and Recommendations" (as adopted in 1992) is cited as "ALI Principles."

3. **Case citations.** For state cases, we cite only to the West regional reporters. An unadorned abbreviation of the state's name means the decision was by the state's highest court. For example,

"493 A.2d 946 (Del. 1985)" cites to a decision of the Delaware Supreme Court,
"316 A.2d 599 (Del. Ch. 1974)" cites to a decision of the Delaware Chancery Court.

The book usually does not indicate subsequent case histories, such as *certiorari denied* or *remanded on other grounds*. For cases decided by the U.S. Supreme Court, the book cites only to the "U.S." reports.

4. **Federal securities law.** We abbreviate references to the major federal securities acts by giving the section number of the act, but not the U.S. Code citation:

Securities Act of 1933, compiled at 15 U.S.C. §77a et seq.,
Securities Exchange Act of 1934, compiled at 15 U.S.C. §78a et seq.

Special Notice

For example, section 10 of the Securities Exchange Act of 1934 is cited as “Exchange Act §10,” without a cross-citation to 15 U.S.C. §78j.

Likewise, we abbreviate the references to rules of the Securities and Exchange Commission by giving the rule number, but not the Code of Federal Regulations citation.

Rules promulgated under the Securities Act can be found at 17 C.F.R. §§230.____.

Rules promulgated under the Exchange Act can be found at 17 C.F.R. §§240.____.

For example, Rule 10b-5 (the fifth rule promulgated pursuant to Exchange Act §10(b)) can be found at 17 C.F.R. §240.10b-5.

This book went to press in February 1999. Corporate law, however, continues to change. To keep up with these changes, we will be posting updates to this book on an Internet web page that may be accessed from the Wake Forest School of Law’s web site or directly at—
<http://www.law.wfu.edu/faculty/palmiter/corp-e&e.htm>

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