LECTURE NOTES: BUSINESS ORGANIZATION
Corporate Organization

I. <u>DIRECTORS</u>

A. <u>Authority and duties of directors</u>

1. Directors Authority- *The corporation acts through its directors, generally by statutory authority.*

2. Delegation of authority to Officers. *While authority may be delegated by the directors to officers, the directors remain responsible and must exercise general supervision over the officers.*

3. Delegation of Authority to Committees: *Breaking the board into smaller committees is usually accomplished by statutory authority, or by authority of the by-laws. The concern is for quorum requirements.*

4. Limitations on Directors authority: *These are generally matters reserved to the shareholders by statute or by-laws, such as: amending the articles of incorporation or by-laws, issuing stock, corporate dissolution, calling special shareholder meetings, merger, acquisition and consolidation, and bulk sales.*

5. Directors duties:
   - *a)* Fiduciary Duty: *Utmost good faith, acting in best interests of the company and shareholders.*
   - *b)* Duty of Care*: Pay attention and be diligent. The "ordinarily prudent person" test is usually applied. Attend meetings, prepare for meetings, participate, inquire into matters, and object where appropriate for the corporation.*
   - *c)* Duty of Loyalty: *Avoid conflict of interest and avoid even the appearance of a conflict of interest. Disclose possible conflicts and abstain from acting in such cases.*

6. Reliance on information from others. If*, and that's a big if, the directors have no knowledge that makes reliance unwarranted, the directors are entitled to rely on information given to them by the officers and employees of the corporation that the director believes to be reliable and competent, to rely on professional counsel such as legal counsel and public accountants, and to rely on board of directors committees if the director reasonably believes the other directors merit confidence.*

B. <u>Personal Liability of Directors</u>

1. Business Judgment rule: *Officers and directors won't be held personally liable for honest, careful decisions within their corporate powers – <u>unless</u>, the decisions involved self-dealing or personal interest of the director, <u>or</u>, the directors didn't bother to learn the facts before making a decision, or voted against their private conviction that the selected course was not in the best interests of the company.*

2. Imposition of Personal liability

a) Breach of duty. *Possible personal liability to the corporation and shareholders for actual damages from breach of duty.*
b) Unauthorized Acts*. Possible personal liability to the corporation for actual damages for actions beyond the scope of authority.*
c) Negligence: *Possible personal liability to the corporation or to third parties for damages from tort negligence.*
d) Fraud or Illegality*: Possible personal liability to the corporation or third parties for damages from fraud or illegal act of the corporation, if the director was aware of the fraud. ("Pure of heart, empty of head" defense.)*
e) Statutory liability:

C. <u>Compensation and Indemnification of Directors</u>

1. Compensation: *Unless the state statutes or by-laws say otherwise, generally directors set their own compensation.*

2. Indemnification: *The right to be reimbursed for expenses except for expenses incurred by wrongdoing.*

> *ORS* 60.411 Insurance. A corporation may purchase and maintain insurance on behalf of an individual against liability asserted against or incurred by the individual who is or was a director, officer, employee or agent of the corporation or who, while a director, officer, employee or agent of the corporation, is or was serving at the request of the corporation as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise. The corporation may purchase and maintain the insurance even if the corporation has no power to indemnify the individual against the same liability under ORS 60.391 or 60.394. [1987 c.52 §101]

a) mandatory indemnification: *When the director is sued as a party mostly just because he is a director, and the director wins, the director may be reimbursed for reasonable expenses.*

> ORS 60.394 Mandatory indemnification. Unless limited by its articles of incorporation, a corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which the director was a party because of being a director of the corporation against reasonable expenses incurred by the director in connection with the proceeding. [1987 c.52 §96]

b) optional indemnification: *There should be authority either in the state statutes or by-laws to permit indemnification provided the director acted in good faith and no reasonable cause to believe an act was unlawful.*
c) prohibited indemnification: *Typically statutes permitting indemnification won't cover acts where the director is sued based on the directors own affirmative wrongdoing.*

D. <u>Election and Term of Directors</u>

1. Election, generally: *Both inside and outside directors are elected for specific terms by vote of the shareholders.*

2. Number and qualification: *Used to be at least 3, but now relaxed to have as few as one. Typically, statutes will call for 3 directors but will permit fewer if there are fewer than 3 shareholders.*

3. Term; *Generally the term is from annual meeting to annual meeting, or until a successor is elected. May have a staggered board, with directors serving for periods greater than a year.*

a) Resignation: *Written notice given to the chairman of the board.*

b) Removal: *Shareholders may remove a director by majority vote at a special meeting called for the purpose. Shareholders may also sue to have a director removed by court order*

c) Filling vacancies: *Some states permit the board to fill vacancies, and other require a special election to be held by the shareholders. In either case the new board member only serves for the balance of the term.*

4. Board of Directors Meetings and Resolutions

a) Generally: *Annual meetings are now optional in most states*.

b) Annual Meetings: *Approve minutes of the last meeting, set dividends, approve reports to be given to shareholders and government, review financial reports, elect officers and set their compensation, approve bonuses, ratify all acts taken by the officers in the previous year, deal with any new business*

c) Notice of meetings

d) Quorum. *This is set by state law, but is typically more than half the members (a majority). By-laws may require a larger number than a majority to constitute a quorum. Under the MBCA, a company can have a smaller quorum than a majority, but even so, the quorum must be more than a third of number of directors constituting a majority.*

e) Minutes: *Minutes must be kept of all meetings, and are inserted in the corporate minute book, for inspection by shareholders.*

f) Board action without meeting: *When action is permitted without a meeting, the action must still be recorded in writing.*

(1) Written consents
(2) Telephone meetings

g) Corporate Minute Books

II. <u>OFFICERS</u>

A. <u>Corporate Officers Generally</u>

ORS 60.371 Required officers. (1) A corporation has the officers described in its bylaws or appointed by the board of directors in accordance with the bylaws <u>which shall include a president and a secretary.</u>

(2) A duly appointed officer may appoint one or more officers or assistant officers if such appointment is authorized by the bylaws or the board of directors.

(3) The secretary shall have the responsibility for preparing minutes of the directors' and shareholders' meetings and for authenticating records of the corporation.

(4) The same individual may simultaneously hold more than one office in a corporation. [1987 c.52 §89]

B. <u>Titles and Duties</u>

1. Chief Executive Officer
2. President
3. Chairman of the Board
4. Vice President
5. Chief Financial Officer
6. Treasurer
7. Secretary
8. Assistant Secretary

C. <u>Personal Liability.</u> *Generally, officers are held to the same standards as directors.*

D. <u>Election and Term of Office.</u> *Typically, officers serve for a yearly term and are re-elected or replaced at annual board meetings. Officers may enter into employment contracts with the board for a longer term.*

III. <u>SHAREHOLDERS</u>
IV.

A. <u>Shareholder Rights and Responsibility</u>

1. Preemptive Rights: *A right to purchase a proportionate share of all new stock issues to protect relative voting power.*

2. Inspection of Records: *Inspection includes the right to copy. Shareholders can sue in court to view the record*

3. Personal Liability: *Exceptions, piercing the corporate veil, and shareholder guarantee of corporate debt.*

B. <u>Shareholder Meetings</u>

1. Requirement for Annual Meeting: *If management doesn't schedule a meeting, shareholders can get a court order.*

2. Requirements for special Meetings. *Purpose of the meeting must be stated in the notice of the meeting, and the meeting can't go beyond the scope of the stated purpose. But frequently, by-laws will let the notice be for a stated purpose, plus "any other matters that may come before the shareholders at the meeting."*

3. Location

4. Notice. *By-laws will frequently state a "record date" to determine which shareholders to notify about meetings. People who purchase shares after the record* *date will not receive notice of meetings. The secretary will prepare an affidavit of notice, which will be inserted into the minutes of the corporation.*

5. Waiver of Notice

6. Proxies. *A shareholder may designate another shareholder, by a written proxy, to vote his shares. Large corporations use proxy statements to relieve shareholder attendance at meetings.*

7. Quorum. *Generally, a majority of the issued shares is a quorum.*

8. Voting at Meetings

a) Voting Trusts. *An agreement to let a trustee vote the shares of several shareholders, as a block vote, to control the corporation. The trustee usually has discretion to vote the shares for the best interests of the shareholders. The test:*

(1) Voting rights are granted for an indefinite period.
(2) The purpose is to control the corporation
(3) All other rights of ownership are retained by the shareholders.

b) Voting Agreements: *Two or more shareholders agree to vote the same way on specific issues. Voting agreements are recognized as enforceable contracts.*

9. Election of Officers

a) Straight Voting / Cumulative Voting

10. Other Actions for Shareholder Approval. *Ratification of directors actions, amendment of articles or by-laws, dissolution, stock issues, mergers, etc.*

11. Minutes of Meetings. *Signed by the secretary and kept in the corporate minute book*

12. Unanimous Consents in lieu of meeting. *In the past, one document had to be signed by all. Increasingly, state laws permit separate consent documents for the same proposal to be signed and kept in the minute book.*

C. <u>Restrictions on Transfer of corporate stock</u>

1. Shareholder agreements restricting stock transfers. *May be a buy-sell agreement or a right of first refusal.*

2. Agreements granting option to purchase stock. *May be a right of a shareholder, or of the corporation to redeem the shares. Close corporations often by statute give the shareholders an option, which is equivalent to a right of first refusal.*

3. Agreements mandating purchase of stock. *The buyer must buy on stated events, for a stated price.*

4. Problems in shareholders' agreements

a) What triggers the mandatory event

(1) Death
(2) Termination of employment
(3) Disability
(4) Proposed sale to third parties

b) Price.

c) Insurance funding

D. Shareholder actions

1. Individual action and Direct Representative actions. *An individual action is a lawsuit by a shareholder against the corporation for damages, as when there is a direct fraud on the individual shareholder. In a representative action (really a special type of class action) the shareholder sues the corporation on behalf of himself and other shareholders, as a representative, as when the directors or officers have issued fraudulent public accounting documents.*

2. Derivative actions. *A derivative action is a lawsuit brought against a 3rd party by a shareholder on behalf of the corporation, when the corporation itself will not pursue the claim. Basically, the shareholder is going after a corporate claim that the agents of the corporation are not seeking. Any benefit the shareholders get by winning the lawsuit, goes to the corporation. Most states try to discourage derivative actions, by requiring a notice and demand period, where the corporate officers can pursue the claim after all.*

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