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1. Validity of Agreement Between Aliyah (A) and Bowen (B)

Closely Held Corporation

A closely held corporation is one that is not subject to public trading of the stock. It usually has a small number of stock holders who are also often either officers or on the board of directors (BOD). To be valid the Article of Incorporation are filed with the state and closely held corps are still subject to all the law governing publicly traded corporations. Corp is governed by both state and federal law.

The facts state that this is a closely-held corporation. No other information is given about the officers or number of people are officers or on BOD or originally incorporated the company. We do know Corp has been successful in business for 20 years. This is a valid closely held corp.

Piercing the Corporate Veil

When the BOD or officers of a closely held or public corp violate their duties or the law or fail to follow the formalities of incorporation, they may be held personally liable if the the corporate veil is pierced when a shareholder (SH) sues and wins in court. The court will then find the offending officer or BOD at fault and personally liable. Closely held corps are more vulnerable to piercing the public veil if they officers or directors are simply using the corp to shield themselves from liability for wrongful acts. Here, the initial facts do not indicate this has occurred in the first 20 years. Subsequent events will be analyzed below.

Majority Shareholders

A majority SH is one that owns a larger portion of the shares than the others. This may be 51% but it may be less than that if there are many shareholders. For example if a SH owns 15% and no other SH owns more than that SH will be a controlling SH.

Here the facts indicate that when A & B combine their shares, they could have a controlling vote. That means that neither of them alone is a controlling SH.

Shareholder's Voting Agreements

SH may enter into voting agreements, but the agreements may not be valid for more than 11 months. Perpetual agreements are not valid. Voting Agreements are a K and as such, must be in writing to be valid.

Here, A & B agreed to work together because they have enough combined power through the combination of their shares to control who is elected to the BOD of Corp.

A and B agreed to vote themselves onto the BOD of Corp.

As SH, A and B agree to vote themselves onto the BOD. The facts indicate they did do this. Notwithstanding the issues that the agreement was not in writing, or no facts say it was, and it was not limited in time, or no facts state it was, this agreement appears to be valid because A and B did what they said they would do. Both have fully performed the first agreement to vote each other on the BOD.

Subject To Agreement

When a SH rights are limited or subject to conditions, it must be conspicuously stated on the front the the stock certificate. This notice must be obviously and bold and is placed there by the Corp who issues the certificate.

Here, A and B placed via stamp a notice "Subject to Agreement" on the back of their own certificates. This does not make a valid notice because it was not placed there by the corporation. However, since facts seem to indicate their voting agreement was oral, the stamp seems to be the only writing. However it does not contain all the terms of the agreement and is not signed by A & B so under K law this would not be a valid written K. It is extrinsic evidence of their oral agreement and may be considered by a court.

A and B have a valid oral K, but not a valid written K. However the court may consider their partial or full performance and find it is a quasi-K because that is what they intended to create by stamping the back of the stock certificates. For the sake of the rest of this answer we will assume the court finds the voting agreement, as to the first part (vote each other onto BOD) is valid.

2. Whether Daya (D) is bound by A and B's Voting Agreement re: Election of Successor

Directors Fiduciary Duties

Directors of a corp are bound by fiduciary duties at all times. They are required to exercise their best independent judgment in good faith and make decisions in the best interest of the corporation. Here, A and B may believe they are acting in the corporations best interest, however by continuing to follow the agreement they made as SH not that they are directors, they are violating their fiduciary duties and the law.

Duty of Care

Directors owe duty of utmost care to the corp. Their actions and decisions must always be made with the goal of what is best for corp. Here, it appears that their voting agreement seems to serve what is best for A and B and Palmer (P) because it gives them power on BOD and P gets power as president. A and B have violated Duty of Care once they became directors and continued with their voting agreement.

Duty of Loyalty

Directors may not usurp business opportunities or do any action that would damage the corp.

Here, A and B elected P as president. Though A and B may have believed P would be good for Corp, P made costly changes without permission of BOD. This decision by P to shift Corp to manufacturing bicycles only may or may not be profitable in the long run, but for now it is costly to corp. A and B's election of P as president may not be what is best for corp and they may have violated duty of loyalty if they knew in advance what P's plans were or if they knew he might unilaterally take drastic changes that harm corp's value.

Previous knowledge of P's intentions

However B discovered P's actions after the fact, so B did not know in advance and she was so concerned she immediately resigned. B likely did not know P's plans in advance and if so may not have violated the duty of loyalty or care. If A knew what P would do, A violated duty of loyalty and care to corp.

Duty to Use Independent Judgment & Special Skills

Directors are to use independent judgment and any special skills they have, such as accounting, legal, or other professional skills in their duties to the corp.

Here, because A and B continue to follow their previous agreement made as SH, they are not using independent judgment. This is a violation of the duty to use independent judgment in the best interests of corp.

Validity of Directors Voting Agreement

Directors of a corporation are not allowed to enter into a voting agreement as they are to act independently using their own best judgment in good faith to act in the best interests of the corp.

Here, though A and B were just SH at the time they entered an agreement. Even if the agreement was a valid SH voting agreement (discussed above), once they became directors, their agreement is not valid. Despite that fact, they continued to follow their agreement, as

analyzed below.

A and B agreed that if they can't agree on successor BOD members, they will abstain from voting in that election

There are no facts to indicate that A and B ever voted on successor BOD members once they became directors. If they had done so in accordance with their invalid BOD voting agreement, it would have been a violation of fiduciary duties of loyalty, care and independent judgment.

A and B agreed to elect Palmer (P) as President of Corp

A and B did in fact elect P as president. Because this was the result of an invalid director voting agreement it is also a violation of the fiduciary directors duties as discussed above.

3. Legal Grounds/Theories Esgar (E) might bring against Corp to enjoin from solely manufacturing bicycles

E is a SH of corp and as such may bring a derivative action the court of the state where the corp is located or where its HQ is. The facts do not indicate where this jurisdiction is, but E may sue in that JDX on behalf of corp to stop corp from doing something that would hurt corps value and in turn hurt E's value.

E may bring derivative suit on grounds that A and B had an invalid BOD voting agreement. He may also allege that A and B are violating thier fiduciary duties of care, loyalty, and independent judgment by voting P in as president. If E can prove that either or both A and B knew in advance what P would do, then he would have even stronger grounds to sue.

4. Legal Grounds/Theories E might bring against P for his actions to only make bikes

Facts do not indicate if P was an original creator of the closely held corp. If so, E may pierce the corporate veil (discussed above) to hold P personally liable. If P is personally benefiting from the switch to only making Bikes he has violated his duty of loyalty. If the decision was not in corps best interest he has violated the duty of care.

E may also say that P is violating his fiduciary duties as an officer and is not acting in the corps best interest. If E can prove that P's decision to switch to only making bikes will financially harm corp, or has already harmed corp, E would prevail.

Likely Outcome of E's actions against A, B & P

Business Judgment Rule

The BJR will protect a corps board, officers from liability if they believed in good faith that their

decision was in the corporation's best interest. Here there are no facts to indicate why A and B and P took the actions they did, but if they can prove they honestly thought it was best for the corporation, they may all escape liability in E's suit.

E is likely to prevail in a suit against the corporation for A, B and P's violation of their fiduciary duties and if E proves the actions P took harmed the corporation, then E could enjoin the corporation from continuing to make only bikes. If E can pierce the corporate veil to show P is using the corporation as his alter ego, then P may also be liable personally.

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END OF EXAM