“A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law.”

John Marshall, Supreme Court Chief Justice, 1755-1835
What does Marshall mean?

- Pre-1880s: corporations chartered for limited time and purpose
- 1880s: concept developed that a corporation was a legal “person” created by law and granted certain powers in accordance with law
- Thus, a corporation has legal rights, though not to the degree a natural person may exercise legal rights
- Note: these rights generally apply to other business forms
Remember, however . . .

- A corporation does business ONLY because PEOPLE make decisions about business activity in an attempt to balance interests and (hopefully) goals of society.
- An “unethical” corporation is a group of humans acting unethically!

Ken Lay & The Enron Gang
Types of Corporations

Based on purpose
- Private (the typical for-profit firm)
- Public (for public purpose; e.g., public utility)
- Non-profit (firm for charitable or benevolent purpose; e.g., Red Cross, Heart Assoc.)
- Professional (firm for professional purpose; e.g., doctors, lawyers, accountants)
Types of Corporations

- Based on Ownership
  - Public (public benefit; owned by government)
  - Private (private benefit; citizen-owned stock)
  - Close (shares held by one or few persons)
  - Subchapter S (tax treatment for close corp. limited to 75 shareholders)
  - Professional (for physicians, lawyers, . . . )
Types of Corporations

- Based on location
  - domestic (in your state)
  - foreign (from another state)
  - alien (from another nation)

- To do business in another state, a “foreign” corp. must register with the state to do business in that state and obtain a certificate of authority
  - Phrase “doing business” is a difficult issue
  - “sufficient minimum contacts” (e.g., Int’l Shoe case)

Levi Strauss is a California corporation with HQ in San Francisco, privately held, not publicly traded.
Doing Business in Other States

- A corporation is *domestic* in the state in which it incorporates and *foreign* in all other states.
- States require foreign companies to register or *qualify to do business* within state borders.
  - Register with the Secretary of State, receive certificate of authority, pay annual fees/taxes, list registered agent.

Delaware corporation, Principal office in Massachusetts, Registered with NC Secretary of State to operate franchises within the state.
Doing Business in Other States

- Opening or establishing an office or storefront IS doing business within the state
- Opening a bank account, owning property, soliciting sales orders, holding or attending meetings IS NOT doing business within the state

Wal-Mart store
Corporate profits are taxed by state and federal government.

Corporations reinvest profits (*retained earnings*) or distribute profits in form of *dividends* to shareholders.

Employees pay income tax on their salary and shareholders pay income tax on their dividends, thus “double taxation” occurs.

The only real disadvantage of incorporation...
Corporate Personnel

- Promoters & Incorporators create the corporation
- Shareholders elect Board of Directors
- Board hires (or acts as) corporate officers
- Corporate officers manage daily operation through employees
Specifics of Formation

- Promotional Activities
- Incorporation Procedures
Promoters

- A promoter creates the corporation
  - Raises capital from investors or banks
  - Prepares incorporation documents
  - Uses a prospectus (document required by federal or state securities laws) to describe expected financial operations of the corporation-to-be; goal of prospectus is to allow investors to make an informed decision
- Usually, promoters become incorporators and corporate officers
Promoters

- General Rule: promoters are personally liable for all contracts and torts made by or on behalf of corporation prior to incorporation
  - Corporations can adopt contracts made on its behalf prior to incorporation
  - Third parties relying on promoters must agree to transfer of liability
Incorporators

- Incorporators sign & file incorporation documents with the Secretary of State
  - State corporate charter, sometimes referred to as a certificate of incorporation or articles of incorporation (organization)
  - Reservation of corporate name
  - Corporate bylaws
- Incorporators generally become corporate officers

Michael Dell
Facts:

- Richert, a promoter, signed a contract with plaintiff by which plaintiff would act as real estate broker for Richert’s firm, which had not yet been incorporated.
- Richert signed in his individual capacity.
- Richert formed the corporation, WDM, Inc.
- Plaintiff showed defendant a property and defendant made an offer, but the deal fell through.
Two months later, WDM entered a lease for the same property using another broker.

Following day, WDM terminated the brokerage contract with plaintiff.

Plaintiff sued WDM for breach of contract.

Trial court entered summary judgment for defendant because WDM had not ratified or adopted Richert’s contract with plaintiff.

Joe & Lynette Jamison of Crye-Leike Realtors
Legal Analysis & Holding:

Appellate court: “After it was incorporated, WDM began to receive the benefits of Richert’s contract with [plaintiff]... evidence supports [plaintiff’s] claim that WDM ratified or adopted the contract after its incorporation ... We conclude that this is sufficient evidence of WDM’s ratification of the contract...”

Reversed and remanded
State corporate code sets the guidelines and methods for formation and operation
- Many states follow Amer. Bar Assoc.’s Revised Model Business Incorporation Act as a guide for state law

Generally, firms incorporate in the “home” state, but states with favorable business laws (e.g., Delaware) are popular choices.
Corporate Charter Requirements

- **Name**: most states require the corporation to bear a unique name within the state and include words indicating incorporation (e.g., Corp. or Inc.)
  - Names should be researched to avoid trademark infringement and reserved prior to incorporation
- **Address & Registered Agent for Service of Process**: a physical address and name of actual person within the state (in case of lawsuit)
- **Name(s) of incorporator(s)**

- [North Carolina Corporations Search Link](#)
Corporate Charter Requirements

- **Corporate Purpose**
  - Broadly state purpose avoids *ultra vires* issues

- **Stock:** number of shares, par value, classes, series
  - Stock cannot be sold unless authorized in the charter (or amended filing)
  - The greater the number, the greater the filing fee
  - “Par value” generally stated as $1/share
  - Stocks may be divided into classes (see p. 806), each with different rights (liquidation, preemptive, conversion, redemption), and further divided into series
Optional Corporate Charter Items

- Additional items may be included in charter:
  - Indemnification of officers and directors (e.g., the U-Haul example, pg. 808) – can be separate agreement
  - Cumulative voting system in which shareholders may pool shares and vote all shares for the same person (e.g., the Gulf Oil example, pg. 809) – must be part of charter to be effective
- Note: including other items in the charter binds the corporation unless the charter is amended
Completing the formalities of the incorporation process creates a *de jure* (by law) corporation

- If substantial compliance with formalities, *no one* may challenge the validity of the corporation

A business that makes a good faith effort to incorporate and operates as a corporation is deemed a *de facto* (in fact) corporation

- *Only the state* may challenge the validity
Corporation by Estoppel

- Sometimes a corporation is “defective”
- A court may apply the theory of corporation by estoppel if a party contracts believing the corporation exists, but tries later to take advantage of the fact the corporation does not in fact exist
Corporate Law

Corporate Powers & Corporate Liabilities

WELL, BOB...
IT'S COME TO MY ATTENTION THAT YOU'RE REGARDED AS THE BOARD MEMBER MOST LIKELY TO HAVE SCRUPLES, SO YOU'LL HAVE TO LEAVE THE ROOM NOW

HOW BOB GOT DEMOTED TO A NEED-TO-KNOW STATUS
After Incorporation

- Shareholders elect directors, directors elect officers: written consent to serve recommended
- Board of directors drafts the corporate bylaws that list the specific procedures (e.g., date of annual meeting, definition of “quorum”)
After Incorporation

- Corporate activities (e.g., stock issuance, board of director meetings, shareholder meetings) must be recorded in the minute book.

A corporate kit
Equity Securities

Equity securities, better known as stock or shares, create an ownership relationship, thus stockholders or shareholders own a corporation.

State laws permit corporations to issue classes of shares with specific rights:
- Common
- Preferred
Claims for dividend payments or asset distribution on liquidation are subordinate to creditor or preferred shareholder claims.

However, common shareholders have the exclusive right to elect corporate directors and exclusive claim to corporate earnings and assets that exceed the claims of creditors and other shareholders.
Preferred shareholders generally receive liquidation and dividend preferences over common shareholders.

A corporation may have several classes of preferred shares with specific rights related to dividend payments, asset distribution upon liquidation, voting, stock redemption, and stock conversion.
Corporate “Rights”

- Corporations have limited constitutional rights and privileges:
  - access to courts (to sue or be sued)
  - the right to due process
  - freedom from unreasonable search & seizure
  - freedom from double jeopardy
- Corporations also have right to free speech, but commercial speech (advertising) and political speech receive less protection than noncommercial speech
  - ...or do they?
The Chevron v Ecuador Fight

Chevron is fighting back against organizations who argue that Chevron has engaged in misconduct in South America and denies that it is responsible for Texaco’s actions.

Cofani women near oil waste pit and poster urging protest of Chevron
The Issue

**Nike v. Kasky (2003)**
Supreme Court of the United States
- Writ of certiorari dismissed as improvidently granted
- Court declined to clarify whether, consistent with First Amendment, Nike, Inc. can be sued for violating state consumer-protection laws concerning allegedly false advertising when such statements were made in response to charges by Nike’s critics and concerned wages, treatment and safety conditions of Nike’s workers at foreign factories
- Settlement followed
Corporate Powers

- **Express Powers**
  - Express powers stated in articles of incorporation and corporate bylaws

- **Implied Powers**
  - Corporations have the implied powers to perform all acts reasonably necessary to accomplish corporate purposes
  - E.g., borrowing money, entering contracts
The "Ultra Vires" Doctrine ("beyond the powers") refers to corporate acts beyond express or implied powers.

- e.g., contracts for unauthorized purpose, such as electronics company purchasing a container load of alcoholic beverages for resale.

Dennis Kozlowski, former Tyco CEO, convicted of grand larceny, conspiracy, and securities fraud. Used Tyco funds to purchase art and luxuries for himself.
Tortious and Criminal Acts

- A corporation is liable for torts committed by agents within the course and scope of employment under the doctrine of *respondeat superior*.

- A corporation may be liable for criminal acts of agents and, under many laws, officers, directors and employees may be imprisoned for criminal acts.
Corporate Management

- Managers have a fiduciary duty to act in the best interests of the corporation’s shareholders
  - Goal: maximize shareholder value
- But what is “maximizing shareholder value”?
- Under the business judgment rule (common law), courts allow managers significant freedom to carry out their responsibilities if they act in good faith

Dec. 23, 2008: Wilmington-based coffee-house chain Port City Java has filed suit against its founder and former COO Don Reynolds. The suit, filed in New Hanover County Superior Court, alleges that Reynolds, his wife, and an LLC held by Reynolds, diverted funds from the company for personal use, including the purchase of real estate in Highland, NC.
What is Good Faith?

- **Duty of loyalty (no conflict of interest)**
  - No self-dealing (unless approved)
  - No competing against the corporation without its consent (corporate opportunity doctrine)

- **Duty of care**
  - Act as an ordinarily prudent person would
    - Rational business purpose, legality, informed decision
  - Act with reasonable belief it is in best interests of firm
Smith v. Van Gorkom

- Known as the Trans Union case
- Proposed leveraged buy-out merger of TransUnion by Jay Pritzker’s (Hyatt Corp.) Marmon Group
- Chairman & CEO Van Gorkom proposed stock price of $55 and gave 20 min. oral report to directors at Board meeting

Why trains? TransUnion created in 1968 as holding company for Union Car Co.
Board approved merger after only 2 hours and without seeking expert advice; shareholders sued

Court found Board breached duty of care to shareholders and could not seek protection of business judgment rule

Defendants agreed to $23.5 M settlement in damages, of which $10 million was covered by insurance

- Pritzker paid remainder
Terminating a Corporation

- Three step process:
  - Shareholders vote to terminate corporation
  - *Articles of dissolution* are filed with the Sec’y of State
  - *Winding Up*: officers and directors pay corporate debts and distribute remaining property to shareholders
- The corporation ceases to exist following the winding up process
Advantages of Corporate Form

- Perpetual existence regardless of personnel changes
- In general, owners are veiled or shielded from liability for acts of the corporation
- However...
Piercing the Corporate Veil

- Court may disregard corporate entity to impose liability on shareholders if certain factors are presented, including:
  - failure to maintain adequate corporate records, commingling funds, injustice, grossly inadequate capitalization, corp. formed to evade obligation or perpetrate a fraud
Rice v. Oriental Fireworks Co.

- Facts
  - J.C. Oriental Fireworks Inc. sold fireworks
  - Rice sued corp. and J.C. Chou personally
  - Trial court granted Chou’s removal
  - Chou allowed judgment against corp. since corp. had no assets to satisfy judgment
- What was the issue on appeal?
  - Can Rice pierce the corporate veil to hold Chou liable?
Rice v. Oriental Fireworks Co.

- What was the court’s holding & reasoning?
  - Discussed 3 criteria for imposing liability on shareholder (control, conduct, cause)
  - Plaintiff presented *prima facie* case: Chou had control of decisions, failed to keep adequate corporate records, inadequate capital in corp. (all assets to Chou), no corporate liability insurance
  - Reversed and remanded

- What preventative measures would you take?
Issues in Corporate Law

- Officer and director indemnification
  - Is it legal/ethical/fair to shareholders and consumers to indemnify directors for acted on behalf of the firm?
- What activities are sufficient to allow a plaintiff to pierce the corporate veil?
- What activities of a parent corporation are sufficient to create liability for a subsidiary corporation?
  - E.g., for subsidiary’s environmental liability
John, Gary, and Rob are active members of a partnership called Swim City. Swim City manufactures, sells, and installs outdoor swimming pools in NC and VA. Partners want to continue to be active in management and expand business into other states. They’re concerned about recent judgments against swimming pool firms in the US. Should they incorporate?
Cecil Hill was in construction and did business as “C&M Builders, Inc.” There wasn’t actually such a corporation. County Concrete Co. supplied “C&M Builders, Inc.” with > $50,000 worth of concrete and wasn’t paid. Supplier filed suit in MD against Hill personally. Hill argued that because supplier thought it was doing business with a corporate entity, C&M was a *de facto* corporation and Hill wasn’t personally liable. Should Hill be allowed to avoid personal liability under the theory of corporation by estoppel?
Test Your Knowledge

True=A, False = B

A promoter is always liable for contracts made during the preincorporation period.

A U.S. business may incorporate in any state.

A *de facto* corporation exists when promoters and incorporators in fact comply with each mandatory requirement to incorporate the business.

*Warrants* are stock options evidenced by certificates.
Preferred shareholders have the exclusive right to elect corporate directors and the exclusive right to dividend payments.

For-profit corporations are financed only by issuing securities in the form of shares.

The MBCA permits shares to be issued in return for any tangible or intangible property or benefit to the corporation.
Exam #1