MGMT20009 Notes

Chapter 29: Management of the Corporate Business

Introduction: SH's are known as the owners of the corp, they affect the way business is run thru their power to elect directors and amend articles. They do not have power to make mgmt decisions. No right to instruct the directors/officers on operating decisions. Directors make the day-to-day operating decisions to the officers. MBCA require SHs to get approval for special actions (merger, sale/lease of substantially all assets, dissolution) from the BOD.

The Board of Directors

- **Powers & Duties**: Directors tend to ratify mgmt decisions made by top execs rather than to take the initiative in making the decisions. MBCA now says: "All corp powers shall be exercised by or under the authority of, and the business and affairs of a corp shall be managed under the direction of, a BOD." MBCA used to say "the business of the corp shall be managed by a BOD".

    - **General Powers of the Board:** MBCA permits the board to take the following actions by itself:
        1. Declaring a dividend.
        2. Establishing the price for the sale of shares
        3. Electing and removing officers
        4. Filling vacancies on the BOD
        5. Selling, leasing, and mortgaging assets of the corp outside normal course of business.

    - **Actions Requiring Board Initiative**: Initiative process requires that the BOD propose the matter to SH's, who then must approve the actions. Required for fundamental changes in the corp:
        1. Amendment of articles of incorp
        2. Merger of the corp
        3. Sale of all or substantially all assets
        4. Voluntary dissolution of the corp.

- **Online Communications**: Directors can now legally communicate official business by email. "**Electronic Communications**" Includes form of comm that don't involve the physical transmission of paper if the comm. Creates a record that can be **retained, retrieved, or reviewed** by the recipient and can be reproduced in paper form.
    - BOD meetings can't take place electronically
    - Permits director resignations to be transmitted electronically.
    - Director actions taken by unanimous consent may be taken electronically.

- **Powers & Rights of a Director as an Individual**: Directors are NOT agents of the corp by virtue of that office. They have power to act for the corp only as part of the board, not as individuals. A director can become an agent if she is also serving as an employee of the corp.
    - *Director has right to inspect the corp books & records*. Necessary to carrying out the director's duty of overseeing mgmt. Right to inspect can be denied where I can be shown that the director has an interest that conflicts w/ that of the corp.

- **Election of Directors**
    - **Number of Directors**: MBCA requires only one, some states require 3. MBCA allows the # of directors to be fixed in either the articles or bylaws. Not necessary to amend

articles when a director dies or resigns and the directors aren't ready to nominate a successor.

- **Qualifications**: A few states require directors to be SHs, some require that a certain percentage of directors be citizens of the state of incorp or of the US. Qualifications set in articles if desired.
- **Nomination**: Elected by SHs at annual meeting. Nominated by current directors, but can be nominated from the floor during the SHs meeting. Candidates nominated from the floor seldom are elected in large corps.
- **Term of Office**: Directors hold office only until the next annual meeting, or until a successor has been elected and qualified. MBCA permits corps to provide for staggered (longer) terms in their articles. A corp that has a board of 9+ members may establish either 2 or 3 nearly equal classes of directors. Then only one class of directors is elected at each annual meeting unless there are vacancies. Staggered terms are to ensure that experienced directors remain on board; however, they are usually adopted to make a corp takeover more difficult.
- **Vacancies**: Can be filled only by a vote of the SHs unless the state statute, the articles, or bylaws give this power to the board itself. MBCA permits a majority of the remaining directors, even tho less than a quorum, to elected directors to serve out unexpired terms. Permits the board to increase the size of the board then to elect a director to the vacancy created.

- **Removal of Directors:** Director may not be removed w/out cause unless this is permitted by statute or by articles or bylaws adopted prior to the director's election. MBCA permits SHs to remove directors w/ or w/out cause. A director who has failed to/unable to attend and participate in directors' meetings or who has acted contrary to the interests of the corp (mismgmt, conflict of interest) can be removed for cause. SHs can remove a director for cause at any time even though the power of removal has been given by the articles or bylaws to directors. Before being removed for cause, a director must be given notice and a hearing.

- **Directors' Meetings**
  - **Frequency**: Usually schedule regular meetings. Large corps meet monthly or quarterly. Small corps where directors are active in business meet formally just once a year. The directors' other meetings are informal w/ no minutes kept.
  - **Notice**: Reasonable notice must be given for special meetings. If all directors attend a meeting, this cures any defect in or failure to give notice. A director who has not received a proper notice may attend solely to complain of the notice, and he would not be held to have been in attendance. Directors may also cure a defect in the notice by signing a waiving notice before or at meeting.
  - **Formality**: MBCA permits directors to act w/out a meeting if all directors consent in writing to the action taken, and permits a director to attend a meeting thru telephone. Only requirement is directors must be able to hear one another simultaneously.
  - **Quorum**: Each director only has one vote, regardless of his shareholdings. Actions taken by a board are ineffective unless a quorum is present (majority of the # of directors fixed by the articles/bylaws). Articles may set quorum at a higher figure.

- **Compensation of Directors**: MBCA permits directors to fix their compensation unless this is prohibited by articles of incorp. Outside directors (not employees of corp) are paid rather modest fees even in the largest corps, but fees are rising rapidly.
  - **Compensation committees** are now expected to practice real oversight, including meeting w/ compensation consultants and their firms HR dept independent of top mgmt.

Officers of the Corp

- **Powers**: MBCA provides that a corp shall have a president, 1+ VP, a secretary, and treasurer. Any 2+ offices may be held by the same person except the offices of president and secretary (permits dual signatures on corp docs).
- **President of Chairman**: Power of officers to bind the corp on contracts is the same of any agent. In addition to express authority, they have implied and apparent authority, and certain officers (president and CEO) may have ex officio authority (authority by virtue of their offices). President or chairman has no power to bind the corp solely bc of his position. Officer liable on losses if he acts beyond his authority.
- **Vice President:** No authority by virtue of that office. However, if title indicates the person is the principal officer of some area of the business, he has considerable implied authority (for example, the VP of mktg has implied authority to do those acts normally done by a manager of sales).
- **Corp Secretary:** aka clerk. Keeps the minutes of meetings of SHs and directors and other general corp records (stockholder records). Office gives the secretary no authority to bind the corp on contracts, but there is a presumption that a doc to which the secretary has affixed the corp seal is properly authorized.
- **Treasurer:** In charge of funds. Has power to pay out corp funds for proper purposes and receives pmts to the corp. Binds the corp on receipts, checks, and endorsements. Does not have authority by virtue of the office alone to borrow $ or issue negotiable instruments.

Duties of Directors and Officers: Unlike directors, the corp officers are agents of the corp. The directors share w/ the officers the same fiduciary duties that an agent owes the principal. Fiduciary duties include:

1.) **Duty to act w/in one's authority and w/in the powers of the corp:** Authority given by statute, articles, bylaws. Directors/officers may be liable to corp if it is damaged by an act exceeding authority or outside scope of corps authority. If they enter an **ultra vires** trxn, justifiable believing it to be w/in scop of corps business, they aren't held liable.
   - **Ratification:** a corp may ratify an unauthorized act by officers/agents thru a resolution of the BOD or the SHs. Implied from acceptance of benefits from unauthorized act. Releases officer/director from liability.

2.) **Duty to act diligently and w/ due care in conducting the affairs of the corp:**
   - **Prudent Person Standard:** MBCA requires that a director/officer discharge his duties w/ "such care as an ordinarily prudent person in a like position would use under similar circumstances" (common sense, practical wisdom, and informed judgment). Greater actual qualifications of individual = greater level of duty.
   - **Officer/Director will have discharged her duty of care if she acts:**
     1.) In good faith
     2.) As would an ordinary prudent person under like circumstances.
     3.) Under reasonable belief she is acting in best interests of corp.
   - MBCA permits directors/officers to rely on opinions, reports, and statements of persons who reasonably appear to be competent and reliable. Duty of care requires making a reasonable investigation before any corp decision.
   - **Business Judgment Rule:** Directors/officers aren't liable for mere errors of judgment when they act w/ care & good faith (honest mistakes in judgment).
     Must meet 3 requirements in arriving at their decision:
     1.) **An Informed Decision**
     2.) **No Conflict of Interest**
     3.) **Rational Basis**: decision can't be "manifestly unreasonable" or gross negligence.

- **Deal Protection Devices** adopted by the board to protect the original merger trxn must withstand judicial scrutiny under an enhanced std of review. implicate
  1. **1.)** Judicial determination regarding the adequacy of the decision-making process employed by the directors, including the info on which the directors based decisions.
  2. **2.)** Judicial examination of the reasonableness of the directors' action in light of the circumstances.
  3. **3.)** Directors have burden of proving they were adequately informed and acted reasonably.

- **Legislative Responses to Increased Director Liability**: Legislations (amendment) to limit directors' liability for breach of the duty of care:
  - **Charter Option Statutes:** authorizes any corp to adopt a specific amendment to its articles of incorp that removes breach of duty as a cause of action for monetary damages against directors. BOD and SHs would have to approve limitation, but officers/directors still would be liable for intentional misconduct, failure to act in good faith, self-interest, knowing violations, breach of loyalty of duty.
  - **Self-Executing Statutes:** Directors will have no liability for breach of the duty of care in the absence of willful misconduct or recklessness. Automatically effective, no board or SH action is necessary to trigger their applicability.
  - **Cap On Monetary Damages Statute:** Adopted by VA. The max liability that may be imposed on directors is the greater of $100,000 or the amt of cash compensation that the director received from the corp during the previous 12 months. Can amend articles to reduce the cap, but can't increase it.

3.) **Duty to act w/ loyalty and good faith for benefit of corp:** Must act in best interest of corp, breach this duty if they try to profit personally at expense of the corp.

- **Self-Dealing**: A director/officer must fully disclose his interest if he enters a contract w/ the corp. Contracts only voidable if unfair to corp. After full disclosure, the disinterested members of the board or the SHs themselves must approve the trxn. Approval doesn't automatically relieve the self-dealing director/officer from liability to corp. MBCA says the initial burden of proving the fairness of the trxn lies w/ the self-dealing director/officer. After proper approval from board/SHs, the burden of establishing unfairness shifts to corp.

- **Usurping Corporate Opportunities**: Directors/officers can't usurp (seize) a corp opportunity. (Ex: Directors can't buy the right to sell a product that would fit into the corps line of goods. If the corp is financially unable to pursue the opportunity, a director or officer may take it). **3 Elements must be met to have usurped an opportunity:**
  1.) Opportunity must have come to them in their corp capacity.
  2.) Opportunity must be related to the corp business.
  3.) Corp must have been able to take advantage of the opportunity.

**The director may still avoid liability* if she can show that the corp waived its rights to the opportunity (director offered the opportunity in full disclosure to the corp but the corp rejected it) May be implied waiver if corp knew of opportunity and failed to act timely.

- **Freeze-Outs, Oppression, & Bad Faith**: