

12: DIFFERENTIATING BIZ ENTITIES

- corporations
 - 3 main types of corps
 - govt corps
 - non-profits
 - for-profit bizs
 - (+) advantages of corporations
 - limits owners' liab/debts (**main advantage**)
 - tax advantages
 - easy to sell/xfer ownership
 - easier to raise capital
 - perpetuity beyond the death of owners (co can exist even after owners die)
 - (-) more costly & complicated to create compared to other types of biz formats
 - (-) taxed at higher rates
 - exceptions to a corp's limited liab:
 - certain state laws (ex: stockholders can be liab for employees' wages/benefits)
 - piercing the corp veil: court imposing personal liab on corp officers/directors/stockholders for corp's unlawful acts
 - if stockholders act as if they aren't separate from corp (ex: co-mingling personal/biz funds)
 - *thin financing*: if investors loan money to corp, court might treat loans as investments and give other creditors priority if corp goes bankrupt
 - *inadequate capitalization*: if parent co starts subsidiary w/ insufficient funds, court may require parent co to respond to subsidiary's debts
 - corp is considered a citizen of state where it's chartered (domicile state)
 - *promoter*: person who creates corp
 - *de jure corp*: corp formed in compliance w/ law
 - *de facto corp*:
 - corp formed w/ that doesn't meet legal requirement despite founders' good faith efforts
 - will be treated as corp, but a state govt can challenge its existence in legal matters
 - stocks
 - common stock: has rights like voting & getting dividends
 - preferred stock: non-voting, but has priority over common stock for dividends/payout
 - par value:
 - arbitrary min dollar value that biz assigns to its shares
 - give investors confidence that biz won't offer shares to others below this value
 - *stock rights*:
 - short-term options to buy shares at a set price (usually discounted from mkt price)
 - usually given to existing shareholders
 - *stock warrants*: similar to stock rights but is a negotiable instrument that can be sold to others
 - *stock options*:
 - permit purchase of certain # of shares at set price
 - usually given to corp's executives
 - *preemptive rights*: rights to existing stockholders to buy portions of a new issue (batch) of stocks relative to that person's existing portion of total shares
 - *stated capital*: total amt of capital contributed by shareholders
 - *capital surplus*: diff btwn stock's purchase price & par value

- *redemption*: when biz buys back its own stock
- treasury stock: stock purchased back by biz but not retired
- legal duties & liab
 - board of directors (BOD)
 - decides corp structure/form (requires stockholder approval)
 - **determines biz pol (does not require stockholder approval)**
 - inside directors: corporate officer who serves on BOD
 - outside director:
 - BOD member who is a corp officer that may not be connected w/ corp's daily operations
 - usually not an employee or stakeholder in the company
 - ***ultra vires*: corp act that exceeds its chartered powers (powers explicitly granted in charter)**
 - corp is liab for torts of agents/employees
 - directors & officers owe duty of care & loyalty
 - stockholder powers
 - elect & remove BOD members
 - approve changes to articles of incorporation
 - make/amend bylaws
 - approve loans to corp's directors/officers/agents
 - ratify board actions
 - sue directors for mis-mgmt
 - stockholders' available actions for remedy
 - class action suit (a few people suing on behalf of many people)
 - derivative suits: stockholder(s) initiating a suit on behalf of the corp for corp's dmgs
 - direct action (stockholder suing for his own dmgs suffered)
- changes in corp structure
 - mergers
 - *share exchange merger*: Corp B exchanges all its outstanding shares to Corp A, in exchange for Corp A shares
 - ***de facto merger*: Corp B sells all/most of its assets to Corp A, in exchange for Corp A stocks**
 - *horizontal*:
 - two companies in same industry & **same** level of supply chain (direct competitors)
 - ex: if Lowes & Home Depot merged
 - *vertical*:
 - two companies same industry, but **different** level of supply chain
 - ex: if Ciquita Bananas & a grocery chain merged
 - *conglomerate*:
 - two companies not linked as customer/supplier
 - i.e., any merger that isn't vertical or horizontal
 - takeover:
 - assumption of control by one corp over another
 - can be friendly or hostile

- methods
 - acquiring co gets cooperation/approval from target co's BOD
 - bypass BOD & get enough proxies votes from shareholders
 - *proxy vote*: shareholder gives right to vote to someone else
 - acquiring co can use votes to:
 - choose new BOD who will support takeover
 - vote directly on approving takeover, which would override BOD
 - **tender offer: purchase offer made a co directly to shareholders, bypassing BOD & usually at price greater than mkt price**
- ins co mergers
 - regulated corps (such as ins cos) can only engage in that type of biz (i.e., ins cos can only merge w/ ins cos)
 - state DOI must approve ins co mergers
 - if non-ins co wishes to buy part of ins subsidiary for investment purposes:
 - *holding co*: corp that buys stock in other corps
 - regulated by Nat'l Assoc of Ins Commissioners (NAIC) Model Ins Holding System Regulatory Act
 - co wishing to gain control of or merge w/ ins co must first file Form A & get state's approval
 - ins subsidiaries must file info w/ state DOI
 - limits dividend payments that ins subsidiary can make to holding co
- dissolution
 - voluntary dissolution w/ BOD resolution & majority stockholder approval
 - stockholders can sue to dissolve if:
 - BOD deadlocked which stockholders can't break & irreparable inj to corp may or has occurred
 - BOD or officers have acted illegally, oppressively, or fraudulently
 - stockholders voting is deadlocked & have failed to elect directors for 2 successive mtgs
 - corp assets are being wasted/misapplied
- reorganize (changing of structure, usually due to Chapter 11 bankruptcy or bad debt)
- partnerships
 - 2+ parties who share ownership & profits/losses
 - (+) taxed at each partner's individual tax rates instead of corp biz rate
 - (+) easier to form than corp
 - *joint venture*: unincorporated joining of 2+ parties to conduct a specific transaction or specific series of related transactions
 - liability issues
 - originally, **contract** law violations **weren't** joint & several (plaintiff must name each person sued)
 - originally, **tort** law violations **were** J&S
 - most states amended law to make both contract & tort law J&S
 - common name statute:
 - permits service of process (legal notice of lawsuit) on a partnership by properly serving any partner
 - i.e., **not** required to serve **every** partner

- innocent or less innocent partner can sue at fault partner for reimb
- partners usually **not** vicariously liab for other partners' criminal acts
- financial
 - partners share in profits/losses/surplus **equally** even if initially monetary contribution unequal
 - **(see example on 9.48)**
 - partners can assign financial interest (rights to profits) but not other partnership rights (to manage, access acct, or inspect books)
- fiduciary duty owed to all partners (each partner must act in best interest of all partners)
- partners can be bound by estoppel even if a decision usually requires unanimous consent
 - 3 elements
 - person who isn't partner says he is or permits others to think he is
 - 3rd party deals w/ that person w/ **justifiable** belief that he is acting on behalf of partnership
 - 3rd party changes his legal position when entering contract due to belief
 - can also be based on what other similar partnerships in area ordinarily do
- dissolution/disassociation
 - rightful dissolution (in accordance w/ agreement & no one at fault)
 - term of partnership ends
 - *partnership at will* (partnership w/o term that can lawfully be dissolved by any partner)
 - **all** partners agree to dissolve even if there is term
 - a partner is declared incompetent by judge or shown to be of unsound mind
 - partner becomes incapable of performing contract (ex: illness)
 - partnership can only continue at a financial loss (i.e., you can't get it profitable)
 - wrongful dissolution
 - innocent partners can choose to end biz & hold at-fault partner for breach of contract, or continue partnership after paying out wrongful partners share less dmgs
 - examples
 - partner becomes bankrupt
 - partner acts in harm of biz (competing w/ partnership, embezzles, etc.)
 - partner willfully or persistently breaches partnership agreement
 - assets distributed in following order
 - partnership' creditors
 - partners' advances (loans made by partner to partnership)
 - each partner's capital (initial investment)
 - surplus to partners, divided in same proportion as profits
- (-) partners usually have unlimited liab for partnership debts
 - limited partnership:
 - 1+ general partners have unlimited liab & 1+ limited partners whose liab is maxed at what they invested (b/c they aren't involved in day-to-day mgmt)
 - **if limited partners exercise any mgmt control, can face unlimited liab**
 - limited liability partnership (LLP):
 - limits liab for **every** partner except in these situations:
 - individual acts of neg or wrongful acts by yourself
 - debts/obligations that you agreed to be liab for
 - debts/obligations expressly undertaken in the partnership agreement

- limited liab cos (LLC)
 - (+) owners have limited liab (like corp)
 - (+) taxed at each individual owner's rate
 - (-) not all bizs are allowed to operate as LLCs
- *professional corps (PC) and professional LLCs*
 - created by some states to meet needs of professionals (ex: accountants, doctors, lawyers, etc.)
 - structures are often complex, with entities within entities
- unincorporated assoc:
 - assoc or group of individuals voluntarily acting together under a common name to accomplish a lawful purpose
 - 6 common types
 - trade assoc
 - labor unions
 - benevolent & fraternal assoc
 - religious
 - club
 - condo owners assoc
 - not considered its own legal entity
 - entity can't be sued (but agents & individual members can be)
 - each member is individually liab for assoc's activities
 - how it differs from partnership:
 - assoc can't hold title to real prop or execute lease in assoc's name
 - a member's withdrawal doesn't cause dissolution
 - profit/expense-sharing is frequently other than per capita (i.e., it's not equally split)
 - assoc's members don't have auth to participate in day-to-day mgmt
 - bylaws
 - qualifications/selection/terms of directors & trustees
 - mtgs (frequency, rules, etc.)
 - qualifications for memberships
 - acquisitions & transfer of prop
 - rights/duties of members
 - options for dissolution
 - members' vote
 - death/withdrawal of majority of members
 - court action on application of creditors/members, or for illegal conduct
 - expiration of period stated in articles or bylaws
 - each member has prop right in assets
 - dues paid become assoc's prop