

Question 7 Selected Answer

1. The shareholders agreement was not properly adopted. The Texas Business Organization Code does allow shareholders to manage a corporation through a shareholder agreement. However in order to have a valid shareholder agreement the agreement must be signed by the shareholders, not the president of the corporation. Moreover, the Texas Business Organization Code does not enumerate the actions which may be taken by a president of a corporation, unlike many other states. However because the president, is deemed an agent of the corporation general agency law grants the president implied authority to do acts in the ordinary course of the business. The execution of a shareholder agreement may not be made by the president first because it is an agreement between the shareholders, not the shareholders and the corporation and also because it is not in the ordinary course of business. Under the facts presented the shareholder agreement must be signed by Beth and Mike in their capacity as shareholders. Beth is not authorized to sign in the capacity as president because the corporation is not a party to the agreement.
2. No. It does not. The Texas Business Organization Code allows shareholders of small corporations to enter into shareholder agreements concerning the management of the corporation. In order for these agreements to be effective the corporation must have a small number of shareholders, since Beth and Mike were the only shareholders. The corporation certainly qualifies. The Code also allows for the shareholders to agree to any thing not expressly prohibited by statute. The shareholders may eliminate the board of directors in order to allow for the corporation to be managed by the shareholders. It may appoint Beth as president and allow Beth to manage the corporation that is the point of a shareholders agreement to allow them to participate in the business operations of the corporation. The shareholders agreement may remain in effect for 25 years. Under the TBOC, a corporation's life may be perpetual. The shareholder's agreement will not be deemed a restraint on alienation provided buyout provisions are included therein, which usually are included.
3. Yes. George is entitle to a rescission of this share. In order for a third party to be bound by a shareholder agreement he must have knowledge of the agreement. Notice is usually provided by a notation on the stock certificate that the stock is subject to a shareholder agreement. This notation is required under the Texas Business Organization Code ("TBOC"). The certificate provided to George did not provide any such notation (much less a conspicuous one as required by statute) further Mike failed to inform George of the restriction. Since George had neither actual or constructive notice of the shareholder agreement he is entitled to a rescission.
4. Yes, George's accountant is entitled to inspect the books and records. Under Texas law, any shareholder owning more than 10% of the stock of a corporation is entitled to inspect the books and records of the corporation at the corporation's principal place of business during regular business hours and upon reasonable notice. This privilege includes inspection by a shareholders agent, such as accountant. George's request clearly met the requirements for inspection. George owns more than 10%, he gave reasonable notice and requested inspector at a convenient time. This satisfies the statutory requirements and inspection should be allowed.

END OF EXAM

Question 7 - Selected Answer

1. No, the shareholder's agreement was not properly adopted. Under the Texas Business Organizations Code (TBOC), an agreement of the shareholder's is allowed but it requires all shareholder's to enter in the agreement. The facts only indicate that Beth and Mike wanted to enter into such an agreement but only Beth signed the agreement. Furthermore, she signed in her capacity as president of Widget Corp., not as a shareholder. After shareholders enter into an agreement this must then be filed with the secretary of the corporation at the principal office. Neither of these things seem to have been done here when the attorney for Widget drafted and Beth signed the agreement. Finally, the agreement should be filed with the Secretary of State in Austin. Thus, this agreement was not properly adopted.
2. A shareholder's agreement can contain just about any term regarding the management of a corporation, this is what the TBOC expressly provides. The code specifically states that such an agreement can eliminate the board of directors and who shall manage the business in place of the board, as well as state the duration of the agreement. Therefore, all of these terms are completely lawful.
3. George is entitled to a rescission of his purchase of shares. The Widget Corp is a very small corporation according to the facts and as such it is not publicly traded on a market such as the New York Stock Exchange. This means there really is no other way for George to sell his shares other than to sell them back to Widget. Furthermore, the stock certificate he received was inaccurate and did not provide information regarding the existence of the shareholders' agreement since the certificate was issued on January 2 and the shareholder's agreement was entered into six months after that. Coupled with the fact that Mike did not disclose this to George when the sale occurred means George had no way of knowing about the agreement. Therefore, George is entitled to a rescission.
4. George's accountant is entitled to inspect Widget's books and records. Under the TBOC, any shareholder is entitled to such an inspection upon demand. Once a corporation receives such a demand it is required to comply. The shareholder may have their accountant look at the books and records for them so the shareholder can understand what is in them. Thus, George's accountant can inspect the books for George.

END OF EXAM

Question 7 – Selected Answer

1. Shareholder agreement was not properly adopted.

Under the Texas Business and Commercial Code, shareholders agreement can be executed to include just about any provisions. Partners can bind the business through the principle of agency. Agency includes actual, apparent or ratified authority. Limited partners do not make day-to-day decisions, are not exercising control but may vote on essential elements of the business. Limited partners may work for the business as employees but may not make executive level decisions. The limitations on partnership agreements are they may not limit the rights of third parties, they may not limit the court's ability to expel a partner and they may not limit the duties they owe each other (duty of care, duty of loyalty). A partnership may file an assumed partnership certificate in the county they are incorporated. This is required where the name of the partnership does not include the surnames of the partners. The assumed partnership certificate must include the original founding names of the partners, their addresses, their purpose for the business (mission statement) and must provide a location of their principal office for service of process. All contracts must be formed by offer, consideration, acceptance, legal capacity and parties must suffer legal detriment. Most contracts must meet the statute of frauds requirement. A shareholders agreement must be signed by the parties to whom it is to be enforced.

Here Beth and Mike, the sole shareholders, agreed to govern their business as a partnership. They both had the intent to form a business relationship that is a partnership and not a corporation because the duties imposed are those only in regards to the intent of the founders. In other words, a partnership is founded on an intent and the ability to share profits. Where the agreement is silent on losses, losses follow profits. The statute of frauds requires all services that cannot be performed within one year be in writing. There are exceptions to the writing requirement. One is an admission by the second party. Here Mike did not sign the shareholders agreement. Only Beth did and as such it is not properly adopted. The agreement suggests the business will be in place for 25 years. If that is the case, then the statute of frauds has been violated.

Therefore, the shareholder agreement was not properly adopted because the parties to the contract did not sign.

2. Shareholder agreement did not contain unlawful term.

Under the Texas Business and Organizational Code which regulates the formation of partnerships and other business entities agreements may be made to effectuate the lawful intents of the founders. As discussed supra the only unlawful terms that a business agreement may not possess are discussed.

Here a partnership does not require a board of directors. The agreement can state who will be the president. Third, the statement can describe who will manage the corporation and the duration of the business may be prescribed.

Therefore, none of the clauses are unlawful terms.

3. George is entitled to rescission.

Under the Texas Business Organizational Code, rescission is a possible remedy for a contract that was entered into without full disclosure. This equitable remedy is appropriate when an individual has no knowledge of necessary underlying facts. Stock certificates normally are required to conspicuously state the formation and intentions and rights of the shareholder. Limited partners and general partners must be clearly identified before stock exchange can be considered equitable and fair.

Here George paid value and received a contract in the form of a stock certificate. George was not informed of his rights within the partnership or whether this was indeed a corporation or a partnership. This agreement between Mike and Beth essentially was a limited liability partnership where the general partner holds more liability than the limited partner. George was not aware that he had no role in managing the corporation. His rescission would trigger a windup of the business and his original contribution after all debts and the addition of profits would be his. Rescission puts the aggrieved party back into the position as if the contract had never been formed.

Therefore, George is entitled to rescinding the deal. He may either request a winding up of the business or seek rescission directly from Mike. Mike may be liable for misrepresentation because misrepresentation has the elements of relaying false material information that is reasonably relied upon that is motivated by malice.

4. The accountant is entitled to inspect the books.

Under the Texas Business and Commerce Code, the books of a partnership may not be unreasonably withheld. Standing to assert a right to view the books can be had by demand on the business that allows a personal representative to view the books as long as you have 5 percent of the overall shares and that you are a shareholder at the time or demand as proper by court order.

Here George wrote to Beth to request his accountant be allowed to inspect a convenient time for Beth. This is not unreasonable and since George had the prerequisite standing to demand access, he should be allowed.

Therefore, George is entitled to inspect the book and records.

END OF EXAM