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(1) The plan to combine Cattleman with the meat slaughtering and meat curing business is a violation of ultra vires but no other aspect of the plan is ultra vires. At issue is whether a corporation can properly be developed for the purpose of meat slaughtering in Texas.

Pursuant to the Texas Business Operations Code (TBOC), a corporation is an entity formed by filing a certificate of formation with the Texas Secretary of State with certain requirements satisfied. Once a certificate of formation is properly filed and accepted by the Texas Secretary of State, a corporation is formed. Within the certificate of formation, specific information must be provided. Within this information is the requirement that the purpose of the corporation must be properly stated. Typically, most corporations will have a very broad purpose - such as any lawful purpose. This will ensure that a corporation may properly make decisions that are outside of their usual practice and not be subject to an ultra vires suit. Ultra vires is a situation in which the corporation exceeds the boundaries of what is provided as their purpose within the certificate of formation. An ultra vires action may be brought by a shareholder who will argue that the corporation is exceeding their set purpose. The ultra vires suit will not make a certificate of formation invalid - it will simply allow the shareholder to seek an injunction to prevent the corporation from taking part in the proposed action at issue. If a corporation provides in the charter that the corporation is for any lawful purpose the corporation must only partake in legal activities as stated by TBOC. TBOC specifically provides that there are certain types of actions that a corporation cannot be used for. One of these acts is meat slaughtering. A corporation in Texas may not be formed for the purpose of meat slaughtering. If this is done, it will be considered an unlawful action and thus possibly subject to an ultra vires suit.

Here, Cattleman - a duly formed corporation in Texas - posted in their certificate of formation that their purpose was to engage in the transaction of any and all lawful business. This is a very broad purpose that is commonly used amongst Texas corporations to prevent ultra vires suits. However, if the corporation does engage in an act that is considered unlawful business then a shareholder has the right to move for ultra vires to enjoin the purpose from going forward. Here, TBOC makes it very clear that a corporation may not be formed for the purpose of meat slaughtering. This is a clear improper business act in Texas for a corporation. Thus, it would be considered ultra vires if Cattleman combines with Ray's business of slaughtering, curing and packing beef. This would mean that Cattleman is engaged in an unlawful business and this is explicitly against the stated purpose in their certificate of formation. Because TBOC makes it clear that meat slaughtering is an improper business practice for a corporation, Cattleman cannot combine with Ray's business. Patsy may properly move to enjoin the combining of the businesses and argue ultra vires as a claim. If the court agrees that this is an unlawful purpose, then Cattleman will be prohibited from engaging in this business with Ray.

Further, Patsy may argue that the money loaned from Cattleman to George to go on the cruise is ultra vires because it indicates a potential breach of duty and George engaging in an interested transaction in which he receives money directly from the corporation as a bonus. Patsy may argue that this is unlawful as a breach of duty of loyalty since George is clearly interested in this transaction. However Patsy will likely not be able to assert this as ultra vires. As a general rule a corporation can lend money as a bonus to its directors and officers for any purpose including a bonus or something not directly associated with the actions of the corporations. Thus, if Cattleman decides to loan the money to George so he can go on his cruise then this is acceptable and will not be considered ultra vires so long as it is approved. Thus, Patsy will likely not have a viable argument for this part of the plan.

Patsy may also argue that the agreement between George and Ray to appoint Ray to the

board of directors is ultra vires since she may argue it is unlawful to agree on who to vote. However, shareholders in a Texas corporation may enter into shareholder agreements in which they agree how to vote. Thus, the fact that George and Ray agreed how to vote in this case is not unlawful and thus there is no ultra vires issue here.

(2) As a shareholder, Patsy can file attempt to enjoin George and Ray from entering the proposed plan by an injunction through an ultra vires action; if this is unsuccessful and the transaction proceeds, Patsy may file a derivative suit. At issue is what rights as a shareholder does Patsy have to oppose the proposed plan between Ray and George.

Generally, one of the many benefits of a corporation is protection of shareholders, directors and officers from liability. Thus, when a director or shareholder acts on behalf of the corporation they are protected by limited liability and will only be potentially held liable if there is a breach of duty of loyalty or a breach of the duty of care. If there is such an act taken by a director or another member of the corporation that injures the corporation, a shareholder has the right to bring a derivative suit on behalf of the corporation against the director or member of the corporation proposing to take the planned action. A derivative action is a suit that is brought on behalf of a corporation when a decision or action is made that directly injures a corporation's interest. The moving shareholder must prove that she owned the shares at the time the decision was made or she inherited the shares as a matter of law, she will duly and adequately represent the corporation's interest, and she sends a written demand that the corporation files its own suit preventing the action from going forward. The demand must be sent 90 days before suit and generally cannot be waived unless the demand would be to no avail and there is no chance that the demand will make any difference on the corporation's actions.

Here, before Patsy proceeds with the derivative suit, Patsy may simply rely on her ultra vires claim as discussed above to properly enjoin Ray and George from taking part in their proposed plan since it would be outside the scope of the stated purpose of the corporation. If the injunction does not follow through and Ray and George follow through with the plan, then Patsy will have to rely upon the derivative action brought on behalf of the corporation

Patsy as a shareholder may bring a suit on behalf of the corporation for Ray and George's proposed plan. The basis of Patsy's argument is that Ray and George's plan will make the operation of the corporation illegal as discussed above in the ultra vires action, and it will provide many benefits to George but not the corporation. Thus Patsy may argue that George failed to act as a reasonably prudent director in making this decision and thus breached the duty of care owed to the corporation. Thus, Patsy may bring a derivative suit for George's act of injuring the corporation and not acting within the corporation's best interest. Patsy will need to prove that she owned interest at the time the decision was made - which she meets here, she will adequately represent the best interests of the corporation, and that she sends written demand in 90 days for the corporation to bring suit against George. However, Patsy can likely argue that because George and Ray are the only other members within the corporation and it is their plan, the demand will be to no avail. Thus, Patsy may properly bring suit against George for failing to act within the corporation's best interest. She meets all of the requirements for a proper derivative action and thus she can maintain the suit against George on the corporation's behalf.

(3) Preemptive rights are rights given to a shareholder, typically in a close corporation, in which the shareholder has the first option to purchase shares of stock issued by the corporation for money. At issue here is whether Patsy had these rights in the proposed plan.

In Texas, there are generally two types of corporations - regular corporations and close corporations. Close corporations are usually formed by only a few people and can have less stringent formalities and rules as compared to a regular corporation. One of the rights that are

common to a close corporation are preemptive rights. Preemptive rights allow a shareholder to purchase shares of stock issued by the corporation that are issued for cash. The interest that the shareholder receives is based upon their percentage of ownership in the corporation. Thus, if the shareholder owns 1/4 of the shares, the shareholder will be able to have the first chance to purchase 1/4 of any proposed shares issued for money. The purpose of preemptive rights in a close corporation is to ensure that close corporations remain close and do not allow outsiders from acquiring more shares than the current shareholders and thus taking over the ownership of the corporation. To have preemptive rights today, the certificate of formation must provide for these rights. If the rights are provided for and the shares of stock are to be issued for cash value then the shareholder can exercise her preemptive rights and take a pro rata portion of the shares.

Here, the certificate of formation provides that there are no limits on preemptive rights. This presumptively means that preemptive rights are available to the shareholders. Here, Patsy owns 25 of the 150 shares that Cattenen has in its capital structure. This means that Patsy will have preemptive rights of 1/6 of any stock issued for cash value. Here, an additional 50 shares of stock were to be conveyed to Ray in exchange for Ray's meat slaughtering business. If this were an issuance of stock for cash value, then it is very likely that Patsy would be able to exercise her preemptive rights and purchase 1/6 of this stock. However, the facts seem to indicate that these shares are being issued in exchange for property rights (the interest in an entity) and not cash. Thus it seems rather unlikely that Patsy will have any preemptive rights in these shares. Thus, because this is an issuance of stock for property and not cash Patsy does not have the ability to exercise her preemptive rights.

END OF EXAM

(1)

Ultra Vires Activity - Listed below

The plan to merge to corporation into the meat processing plant

Under the Texas Business Organization Code, a corporation must include a short plain statement of the purpose of of the code in its certificate of formation. Here, the statement of the purpose of the code states that it is "transaction of any and all lawful business." Under the TBOC, any transactions or actions by the corporation that go beyond the purpose of the organization are considered ultra vires. The organizations actions merging with a meat processing plant would be considered ultra vires activity. Under the TBOC, it is unlawful as a coporation to be in the business of slaughtering animals. If the merger were to occur, the corporation would not be in violation of law. Based on the statement of purpose in the corporation this would be a violation of law and therefore outside the purpose of the organization, which was for any lawful purpose. As such it would quallify as as ultra vires activity because they would now be operating illegally which is outside the statement of purpose.

Adding Ray to the Board of Directors

The collusion of George addition Ray would breach his fiduciary duty of loyalty and care to Patsy, the other board of director. George as a director owes a fiduciary duty to Patsy and the organization. The collusion to add Ray and move forward to add Ray would violate his fiduciary duties to the corporation and to Patsy as another director. Additionally, in order to add another board of director it requires a majority vote of the board members which the board can do at its discretion upon a majority of the board of directors. This would be invalid.

Loaning George \$100,000

Under the TBOC, board of directors are able to give loans from the corporation so long as it's in the best interest of the corporation. Each director owes a duty of care, good faith and loyalty to the coporation, other board of directors and shareholders. If, a board member agrees to make a loan then it must be in the best interest of the organization. Here, once Ray becomes a director it states that it will loan the money for a vacation. This is clearly improper and not in the best interest of the organiation. by loaning the money, both Ray and George would be in breach of their fiduciary duties to corporation to act in the best interest of the corporation.

(2)

Patsy would need to intitiate a derivative suit against the coporation. Under the TBOC, a derivative suit is a suit against the corporation initiated by one of the shareholder to redress a wrong that the corporation. Essentially the shareholder steps into the shoes of the corporation to redress a wrong. In order to being a derivatrive suit certain requirements need to be met. (1) The shareholder must be shareholder at the the wrong was committed (2) the person must adequately represent the interest of the organization (3) before bringing suit, the SH must first make a written demand on the organization to redress the wrong (4) the SH must allow 90 days

for the corporation to redress the wrong before bringing suit (5) A group of disinterested directors will investigate the claims to determine if going forward with the suit is in the best interest of the organization, whether the claim is winnable and whether the money can be better spent elsewhere. After the investigation, the uninterested directors may choose to go forward with the suit or dismiss the suit.

Here Patsy was a shareholder at the time the wrongs were committed therefore she has standing to bring the derivative suit and she adequately represents the interest of the other shareholders. She would need to first make a demand to redress the wrong as stated above and allow them 90 days to redress the. It would be difficult to have a group of uninterested directors complete the investigation because there such few board members, however she can still move forward with the suit. As such, in order to redress the wrong, Patsy can move forward with a shareholder derivative suit.

(3)

A preemptive right is ability to repurchase shares when shares are be distributed for money in order for a SH holder to obtain their percentage of the shares in the corporation. When shares are issued for money, if preemptive rights are available, they must first offer shares to the holders of preemptive rights to buy to continue to obtain their percentage of shares they own. If the certificate provides for preemptive rights, shareholder has preemptive rights if they have owned shares for at least six months or if they own 5% of the shares in the corporation. A person is not entitled to preemptive rights if shares are not distributed for money. Here, if the corporation provides for preemptive rights, she would be have them because she meets the requirements. However, in this situation, when George issues shares to Ray, Patsy would not be entitled to enforce her preemptive rights because they shares are not being issued for money, but rather being issued to Ray. As such, Patsy would not be able to enforce preemptive rights if the corporation provided for them.

END OF EXAM

1) Under the Texas Business Organization Code (TBOC), rules provided that for the lawful formation and existence of a corporation, the corporation must state the purpose of the corporation. TBOC requires to state their purpose in the certificate of formation (which upon proper submission to the Secretary of State, and upon acknowledgement by the secretary of state, will cause the corporation to come into existence). Here, Cattleman's certificate of formation states that its purpose is the "transaction of any and all lawful business." While TBOC requires to state the purposes, generalizations such as "any lawful purpose" like the one provide by Cattleman's certificate are valid. Now, an ultra vires activity is an activity that goes beyond the scope, or is completely different from the corporation's purpose. The fact that a corporation engages in an ultra vires activity is not per se invalid or in violation so long as it is not invalid or specifically prohibited by TBOC. TBOC specifically prohibits criminal conduct as an activity, and it also provides that Corporations may not engage in cattle raising, nor may engage in the business of meat processing, slaughtering, curing, and packing beef. Here, George planned to engage Cattleman in the business of meat processing, slaughtering, curing, and packing beef. Such plans are seen not only as an ultra vires activity but also as strictly prohibited by TBOC. Additionally, irrespectively of George's plan, Cattleman is already in strict violation under TBOC given that Cattleman is in the business of cattle raising.

Independently of the fact that cattle raising, nor may engage in the business of meat processing, slaughtering, curing, and packing beef are prohibited conduct by the corporations, assuming that they were valid, the plan between George and Ray to convey a business plan in exchange to 50 shares is not an ultra vires in the sense that the directors of a corporation have the discretion to determine what constitutes consideration in exchange of shares, meaning, what would be a good price or exchange for a share of the company. The plan by George and Ray also includes a plan to vote for the purposes of adding Ray to the board of directors. This act is not per se an ultra vires activity since directors may engage in agreement to cast a fair vote or to propose a new director for the board. The last part of the plan provides that once Ray become a director, Cattleman will loan George \$10,000 to pay for a Caribbean cruise. The board of directors owe to the corporation a duty of loyalty (to account the corporation for any benefit derived, to act in the best interest of the corporation, and restrain from adverse interests), and duty of care (ordinary care of a prudent person under the circumstances taking in consideration the best interest of the corporation). Additionally, any action by the board of directors is assessed under the business judgment rule (informed decision under reasonable standards). It seems here that there may be a violation of duty of loyalty and care to Cattleman since a Caribbean cruise seems to be an adverse interest and a benefit derived from Cattleman. TBOC has provided that a director may receive a loan from the corporation but only if it is in the best interest of the corporation. Here there seems not to be any interest to Cattleman, therefore such act is ultravires.

2) Patsy may prevent the plan proposed by George and Ray from being implemented by filing a notice of intent to file a derivative suit and injunction. Under TBOC a shareholder may bring a derivative suit and an injunction if a shareholder believes that the board of director has acted in a way that has caused an injury or loss to the corporation to which the board of directors acted in bad faith, or within gross negligence. For a shareholder to have standing to bring the suit, he must first deliver a notice to the board of directors of his intent to file the suit at least 20 days before the filing of the suit and must wait for 90 days for a response from the board (subject to

impending harm which will allow the injunction to be filed to avoid further harm). Shareholder must also have a standing by: 1) bringing the suit for the benefit and on behalf of the corporation (and not have any self-interest on it), 2) must have been a share owner at the time that the harm occurred, or acquired the shares through gift or bequest, and must 3) remain a share owner or -acquired by gift/bequest- through the proceedings of the suit.

3) Preemptive rights are rights to purchase issued shares that are set up for sale "for money" in a calculated percentage from the shares that the shareholder owns at the time of the sale. This right was automatic until the revocation of such right back in September 1 of 2003. Now in Texas, to have such right it must be specifically stated in the stock's certificate and certificate of formation. The fact pattern states that the certificate of formation provides for no limits on preemptive rights. Arguably, TBOC would require a more specific language such as "with preemptive rights" since the law has been very clear in no automatic right and in the interest of fairness for potential purchases, such right must be conspicuously stated. Assuming that the language is enough to allow Patsy a preemptive right, she would not be able to enforce it in the current transaction. As mentioned before, the preemptive rights are issued for money. Precedence in law and in accordance to TBOC, there is no preemptive right when the shares are exchange for business, or are given in compensation to an officer or director. Here, the 50 shares are going to be given in consideration for the meat processing plan and not for money. As a result, Patsy would not have a preemptive right,

END OF EXAM
