Question MEE 3 – July 2022 – Selected Answer 1

1. The Land Sale agreement with the bank signed by Carol binds the corporation.

A corporation's directors run the corporation. They are empowered to select agents to do the day to day operations of the corporation.

Here, the board is comprised of Brian, Danielle, and a third director, selected by Danielle. The board unanimously decided that Danielle was responsible for securing the financing necessary to build the homes. The board unanimously authorized Danielle to hire Carole, a consultant, to negotiate financing agreements on behalf of the corporation. Danielle asked Carol to act on behalf of the corporation to obtain the loans, and Carol agreed to do so.

Actual authority is established when a principal vests in an agent to act on the principal's behalf. The agent then binds the principal, if he enters into a contract with a third party, disclosing the identity of the principal, and is with the scope of his agency.

Here, Corporation's purpose is to pursue property development opportunities and any other lawful business. Carol was authorized by the board to act as a consultant, and then authorized by Danielle to act on the behalf of the corporation to obtain the Loans. A reasonable person would take this to mean that Carol was authorized to sign on behalf of the company, when procuring loans.

Carol did not act within the scope of her actual agency, instead of procuring a loan she sold the land.

She may have been empowered to do so through apparent agency. this is established when the principal makes a representation to a 3rd party, that a reasonable person would take to mean that the 3rd party is the agent of the principal.

Here, this has not happened. The Corporation has not spoken to the third party outside of Carol's interactions. Thus it is not bound through actual or apparent agency.

a. Carol's land sale agreement was ratified.

Nonetheless, a majority vote of the board of directors will bind a corporation to a deal that was made without proper authority. Here, Danielle called a a special meeting of the board to approve it. Board meeting held 3 days after meeting was called. Danielle and the 3rd director voted to ratify the land sale agree under the terms of the written agreement signed by Carol.

Because there is no self dealing with Danielle & the third party for this vote, the corporation is bound by the ratification.

2. The Bonus payment to Danielle, which was approved by the majority of the board of directors was improper.

At issue is whether the special director meeting was called.

A special director meeting can be called at any time by any director, so long as there is reasonable notice to the directors, of the place, time, and date, and purpose of the meeting. Here, the purpose was given as to "approve the agreement signed by Carol." Brian was given 3 days notice of the meeting by Danielle.

Improper notice will be waived if a director votes at the meeting. Here all 3 directors voted, and thus waived the notice objection.

It is arguable that the awarding of the bonus to Danielle is sufficiently related to the purpose given (approving of the land sale), that the issue was properly heard, because the bonus was the sales proceeds out of the sale.

The main issue here is whether Danielle and the third director violated their duty of loyalty by voting.

A director owes a duty of loyalty to the corporation, to act on the corporations best interest and to not usurp opportunities for the corporation to make money. A defense to this is if the decision is in the best interest of the company, as evidenced by a board vote.

In order for the board to properly ratify an otherwise interested deal with a director, or other person who owes a duty of loyalty to the company, a quorum of the directors that have no interest in the deal must vote and approve the deal.

Here, all 3 directors were present. Brian is the only truly disinterested director, but the vote requires 2 directors, so the 3rd director who has no direct interest in the outcome votes. This provides a split decision, because Danielle, as an interested party, cannot vote, and thus the bonus would not have been approved.

Thus, since Danielle did vote, she violated her duty of loyalty by self dealing. The 3rd director may have violated her duty of loyalty, because she is controlled by Danielle.

3. Brian has sufficient grounds to seek the judicial dissolution of the corporations.

A shareholder may seek to dissolve a corporation. In order to do, he must first give hte board notice of why he would be suing for dissolution, and then give the board 90 days to remedy the problem or to bring suit themselves in order to remedy the problem. The shareholder does not need to notify the board prior to bringing the bring suit to dissolve the corporation, if the notification would futile. A proper ground for seeking the dissolution of a corporation is fraud on the part of the directors of the corporation.

Additionally, a shareholder plaintiff must have been a shareholder at the time of teh alleged injury, and throughout the shareholder suit.

Here, Brian is both a director and a shareholder. He owns 20% of the shares of the company. He was a shareholder for the entirety of the life of the corpration so far, and was a shareholder at the meeting where the alleged fraud occurred. He is still a shareholder. Thus he is a proper plaintiff.

He seeks to dissolve the company because of fraud. Shortly after the corporation was formed, the board agreed to periodically consider whether to issue dividends. At the meeting, the board, voted to award Danielle a bonus of all the the sale proceeds. The board members at that time were Brian, (who voted against the bonus), Danielle, and a third boardmember who Danielle appoints (as 80% share holder). Danielle and the 3rd boardmember are thus interested parties and should not have voted at the meeting.

Because the majority of the board is Danielle, or controlled by Danielle, the notice to the board will be futile, and thus Brian does not need to notify the board of directors of the suit before he files.

Additionally, they seem to be concealing something, at the special director's meeting Brian requested to see all accounting records related to the purchase and sale of the land. He did so properly. The board refused the request, with Danielle and the third party director voting against it.

Any shareholder is entitled to the right to inspect the financial records of the corporation at anytime. The failure to provide adequate right to inspect the financial is a breach of the fiduciary duty the corporation owes to the shareholders (Brian).

Question MEE 3 – July 2022 – Selected Answer 2

1. The issue is if the corporation is bound by the land-sale agreement with the bank signed by Carol.

<u>(a) Agency authority</u>
The board unanimously authorized Danielle to hire Carol to negotiate financing agreements on behalf of the corporation. Both Danielle and Carol were of sound mind, age, and ability to have capacity to act as agent and principal. Thus, Carol was acting as agent of the corporation. An agent may operate from three types of authority: actual express, actual implied, and apparent.

An agent has actual express authority when the principal has explicitly instructed the agent or given the agent permission to complete a task. Here, Danielle instructed Carol to negotiate financing agreements. Danielle did not mention anything about selling the parcel of land. Thus, Carol had no actual express authority to sell the parcel to the bank for $6 million.

An agent has actual implied authority when the agent takes an action that was reasonably necessary to accomplish the principal's goals or to benefit the principal, and that the agent reasonably believes the principal would consent to. Carol likely did not have actual implied authority because it was not necessary for her to sell the parcel to the bank in order to obtain the company's goal of obtaining financing. The fact that Danielle did consent to the sale of the parcel weighs favor of Carol having actual implied authority. At the core, though, the completely separate nature of obtaining financing for buying a parcel versus negotiating the sale of a parcel renders it very unlikely that a court would find Carol had actual implied authority.

Finally, an agent has apparent authority when the principal has manifested to the third party that the agent has authority to enter into the transaction. Carol contacted the bank under the corporation's blessing. However, the facts indicate that when she did so, she asked the bank if they would provide financing to the corporation. The bank declined and instead offered to enter into a completely separate transaction. Under these facts, the corporation did not manifest to the bank that Carol had the right to sell the parcel on behalf of the corporation. Thus, Carol had no apparent authority.

Generally, when a principal is fully disclosed, the principal is liable to the third party and the agent is not. Here, the principal was fully disclosed, as Carol told the bank that she was acting on behalf of the corporation and identified it. However, because Carol acted outside the span of any actual or apparent authority, she, too, is liable on the contract, as well as the corporation.

<u>(b) Ratification</u>
A principal ratifies a contract when they are informed of all material terms of the contract, accept the entire contract, and reap the benefit of the contract. The corporation ratified the contract when Carol described to the board the material terms of the agreement and the board voted by a majority to accept it. The board accepted the benefit of the transaction, the $6 million, and decided to give it to Danielle.

Thus, the corporation is bound by the contract.

2. The issue is if the bonus payment made to Danielle was proper.
A director is an agent of a corporation and has a duty of loyalty and a duty of care to the corporation. The duty of care requires a director to act with reasonable attention, prudence, and skill when performing their duties as a director. The duty of loyalty requires a director to act in the best interests of the corporation, to refrain from self-dealing, and to refrain from usurping the corporation's business opportunities for a personal benefit. Normally, shareholders do not owe any duties to other shareholders. However, when one shareholder is a majority shareholder, the majority shareholder owes a duty to not cause a loss to the minority shareholders by withholding information or wrongfully dominating the decisionmaking of the corporation.

<u>(a) Business judgment rule</u>
In general, when analyzing the fiduciary duties owed by corporate directors to the corporation, the business judgment rule operates to create a presumption that the person in question acted in the best interest of the corporation. This rule is to prevent courts from second-guessing corporations' legitimate business decisions. However, the BJR does not apply when conflicts of interest and self-dealing are present. Thus, Danielle and the third director may not have their actions analyzed under the BJR.

<u>(b) Duty of loyalty</u>
The bonus payment to Danielle breached the duty of loyalty of Danielle and the third director to the corporation itself. First, paying the entire proceeds of a major transaction -- $6 million -- to one person, any person, for no apparent reason is clearly

not in the best interests of the corporation. Second, Danielle obtained a large personal financial benefit from the transaction. This is a clear conflict of interest and an example of self-dealing, both of which violate her duty of loyalty to the corporation. The third director appears to be controlled by Danielle's interests for some reason and can thus be argued to have breached their duty of loyalty as well, although they did not obtain a personal benefit.

Finally, Danielle breached her duty of loyalty to Brian, a minority shareholder. She caused his investment to suffer a major loss when she awarded the corporation's $6 million profit to herself.

(c) Safe harbor
A self-dealing transaction may be nonetheless permitted if it was approved by a majority of disinterested shareholders, a majority of disinterested directors, or if the terms were fair. Here, the majority of directors approved it, but the directors were not disinterested: Danielle had control over the third director, and Brian, the disinterested director, disapproved. A majority of disinterested shareholders did not approve it: Brian, the only disinterested shareholder, disapproved it. Finally, the terms were not substantively fair to the corporation, as stated above; the corporation suffers a major loss and reaps no benefit.

Thus, the payment was improper.

3. The issue is if Brian has sufficient grounds to seek the judicial dissolution of the corporation.

Judicial dissolution is an extraordinary remedy. Shareholders may seek corporate dissolution if there is an insurmountable deadlock in the board of directors or the shareholders' ability to make decisions. A court itself may order dissolution if a corporation has failed to file the requisite regulatory disclosures or failed to pay taxes. Finally, a director may seek judicial dissolution on grounds of bad faith, fraud, or other serious violations of a corporation's duties to act with good faith and reasonable care, particularly if the violation occurred as a result of an *inter vivos* action.

Danielle and the third director almost certainly acted in bad faith when they approved the sale of the parcel to the bank and the subsequent payment of the proceeds to Danielle. The corporation's articles state that the purpose is "to pursue property development opportunities and any other lawful business." The broad nature of the articles make it difficult for any action relating to property development or sale to be deemed an *inter vivos* action, which occurs when a corporation acts outside of its allowed scope of authority. However, the transaction at hand likely is one of the few actions that a court **could** properly characterize as *inter vivos*. Because it was the sale of a property that the corporation had not developed -- in fact, Brian intended to develop the parcel, but the sale prevented him from developing it -- it does not fit into the first clause. Second, the transaction was likely unlawful, as discussed above. It was taken in bad faith and breached the directors' duty of loyalty to the corporation, which is against the law. Thus, it is an *inter vivos* action.

The question does not ask if Danielle may be held personally liable and required to return the $6 million payment. However, the factors for piercing the corporate veil are akin to those that would be considered here. It appears that the corporation has become an alter ego of Danielle and is simply existing to fill her pockets as opposed to fulfilling any true corporate purpose.

Thus, Brian may properly seek judicial dissolution of the corporation.

Question MEE 3 – July 2022 – Selected Answer 3

1. The corporation is bound by the land-sale agreement with the bank signed by Carol because Danielle ratified it.

The issue here is whether the corporation is bound by the land-sale agreement due to Carol's actual or apparent authority to do so.

A corporation is only bound by agreements made by agent's of the corporation if the agent had express or implied authority to bind the corporation.

An agency relationship is created when a principle manifests through words or conduct that the agent act on the principle's behalf and the agent agreeds. The authority can be express or implied. Express authority is the authority an agent reasonably believes he has based on the words or conduct of the principle. Implied authority is all authority necessary to carry out any express obligations.

Apparent authority is the reasonable belief by a third party that the agent has express or implied authority to act on the principle's behalf and bind the principle.

Here, Carol is an agent on behalf of the corporation as Danielle had the authority to hire Carol to negotiate financing agreements on behalf of the corporation with several banks. She explicitly "asked carol to act on behalf of the corporation to obtain the loans and carol agreed to do so." Here, Carol was an agent with express authority only to negotiate financing agreements of land with several banks. Therefore, this authority is very narrow.

Carol did not have actual authority to sell the land to the bank because she was only provided with authority to get a loan for the corporation to buy the property.

Apparent authority may exist because the bank believed Carol had the authority on behalf of the corporation to deal with the bank.

However, the principle may ratify an agreement otherwise outside the scope of the agency. Ratification consists of an express agreement or consent to the out-of-scope conduct after the fact. By consenting and approving afterwards, the principle becomes bound by the agreement.

Ratification occurred here because Carol informed Danielle of the sale agreement she made with the bank and Danielle agreed it was in the corporation's best interest and properly called a special meeting on the board to approve it.

For typical agreements, a majority vote by the board is sufficient to ratify/approve of any ordinary course of the corporation's conduct. However, extraordinary (out of the ordinary course of business) conduct requires unanimous vote to approve.

Ordinary course of business can include the corporation's purpose and any other "lawful business" if specified within the articles of incorporation.

Here, only Danielle and the third board member approved of the land contract. Therefore, it was not unanimous. However, only a majority was needed since this was likely in the ordinary course of the business to "pursue property development opportunities and any other lawful business."

2. The bonus payment made to Danielle was not proper.

The issue here is whether a majority or unanimous vote is required for bonus payments.

A majority vote among the board of directors is required for a bonus or dividend payment by the corporation. However, only uninterested parties may vote in these matters. Meaning that all interested parties must be removed from the vote and do not count.

Here, Danielle and the third director approved of this bonus to Danielle which would constitute an ordinary majority. However, Danielle's vote would be excluded because she is an interested party. Danielle is an interested party because she was up to receive all the sale proceeds to Danielle as a bonus payment. Furthermore, one could argue that the third director is an interested party as Danielle appointed her. If so, this would make Brian's vote the only one to count and therefore, the same result would occur - the bonus payment would be invalid.

Since there is a tie, the bonus was improperly approved and therefore, not proper.

3. Brian has sufficient grounds to seek the judicial dissolution of the corporation.

The issue here is whether the court would find dissolution in the best interest of the corporation.

In order to seek judicial dissolution of the corporation, the court must find that a director has breached a fiduciary duty to the corporation or that the corporation's main purpose is frustrated.

Here, the court could find that Danielle violated her fiduciary duty to the corporation and other shareholders when she began acting in her personal self-interest and manipulating the corporation to benefit her. Here, Danielle appointed the third director of the board and then voted to allocate the complete sale proceeds to herself as a bonus. This seems like self-dealing and unfair to Brian and the corporation.

The corporation's purpose might be frustrated if one director maintains such an interest that the minority shareholders are oppressed. The oppression of minority shareholders could allow the could to dissolve the corporation as the minority shareholders have no way of removing themselves from the corporation or get equal footing.

Here, Brian owns 20% of the corporate shares but Danielle owns 80%. This is very unequal and would not be fair is Danielle completely controls the business and Brian has no way of getting himself out of that position.