

Business Organizations II – Section 2

HYBRID

Spring 2025

Professor: P. Stirling

**General Instructions:**

Answer Three (3) Essay Questions.

Total Time Allotted: Three (3) Hours

Recommended Allocation of Time: Equal Time per Question

## **Business Organizations (Corporations)**

**Spring 2025**

**Final Exam**

**Prof. P. Stirling**

Background facts that apply to all three exam questions:

Ink, Inc. ("Ink") is a California corporation with business activities throughout the US and is registered as a foreign corporation in many states. It is the largest supplier of ink to the printing industry as well as other industries. It is a public corporation registered on the NYSE. Its shares currently trade for \$50 per share, and it has 10,000+ shareholders. It has a board of 10 directors, 9 independent, and one who is the original founder of the company and holds 5% of the shares. Its year end is December 31, so its annual shareholders' meeting is April 20 of the following year.

### **Question 1**

25 of the shareholders would like Ink to adopt a policy on environmental, social and governance (ESG) issues, as Ink does not have such a policy now. The shareholders are particularly concerned about the lack of diversity in the management, as well as the recent tank explosion at the main plant in California that caused a large spill into the Salinas river. The shareholders come to you to ask for instructions on how to approach the directors to add this issue to the proxies for the next shareholders' meeting. They also want to see the corporation's records on its safety and prevention expenditures as support for their request. Please provide them with the procedure for accessing the records as well as the proxy request. They are a well-educated group so make sure to provide the legal support and authority.

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## **Business Organizations (Corporations)**

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### **Question 2**

Ink's directors feel the time is right to expand and would like to acquire Laser, Inc., ("Laser"), a California corporation that manufactures, sells and repairs laser printers. Laser has been the defendant in a number of lawsuits for safety issues (the machines seem to catch fire easily.) There are lingering and possible future liabilities in Laser's books. The same group of shareholders as above come to you wanting to know if they can stop the purchase. Please explain to them, including reference to the relevant law, the powers of shareholders in this area, as well as the responsibilities of the directors.

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## **Business Organizations (Corporations)**

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### **Question 3**

Tarquin, one of Ink's directors (an independent director) recently met a college friend who told him about his new business creating and producing vegetable dyes and ink for textiles and packaging. The company, named Clean, is still in the startup phase, but there will be a big demand in many industries. (Ink uses only semi-toxic chemicals for its products.) Tarquin comes to you to ask about whether he can invest in his friend's business. He has not spoken to any of the other directors of Ink, and he would really rather not share this opportunity with them. Please explain the California corporate laws that apply to his situation, including his responsibilities and liabilities.

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## **Business Organizations (Corporations) Spring 2025**

### **Final Exam**

**Prof. Stirling**

### **ANSWER 1 (OUTLINE)**

**20% Organization (Similar headings – boldfaced below)**

**20% Issue (Spot all issues)**

**20% Rules (Name all rules – underlined below)**

**20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)**

**20% Conclusions (Provide correct conclusions – as *italicized* below)**

**Issues: Procedure for viewing records, procedure for adding to proxy, procedure if directors refuse**

**Do the shareholders have a right to view the corporation's documents?**

Shareholders have limited rights with regard to the control of the corporation. In addition to voting for board members and any items during the annual meeting, they also have rights regarding the inspection of corporate records.

Under CA Corp Stat 1601(a). The accounting books, records, and minutes of proceedings of the shareholders and the board and committees ... shall be open to inspection ... upon the written demand on the corporation of any shareholder or holder of a voting trust certificate at any reasonable time during usual business hours, for a purpose reasonably related to the holder's interests as a shareholder.

In this case, so long as the shareholders make a written demand and follow the other requirements noted in section 1601(a), they may view the records for any purpose related to their interests.

*Accordingly, the shareholders may make a written request to inspect the records with regard to the safety history and the ESG policy (or lack thereof).*

**What is the option if the directors refuse?**

In accordance with California Corporate section 1604: In any action or proceeding under Section 1600 or Section 1601, if the court finds the failure of the corporation to comply with a proper

demand thereunder was without justification, the court may award an amount sufficient to reimburse the shareholder or holder of a voting trust certificate for the reasonable expenses incurred by such holder, including attorneys' fees, in connection with such action or proceeding.

1605: If any record subject to inspection pursuant to this chapter is not maintained in written form, a request for inspection is not complied with unless and until the corporation at its expense makes such record available in written form.

Should the directors of Ink refuse, the shareholders have the option of requesting the superior court to assist.

*Accordingly, if the directors refuse, the superior court may order the directors' compliance with the request, and award expenses to the shareholders and production of the record in written form.*

**Do the shareholders have a right to request an additional issue is added to the proxy for the annual meeting?**

SEC section 14(a)(8) of the Securities Exchange Act of 1934 provides a framework allowing a public company shareholder to request that a proposal be included in the company's proxy statement, to be voted upon at a company's shareholder meeting.

In order to have a proposal included in the proxy, the shareholders must be current shareholders of record.

Under the same rule, the directors may exclude a proposal that "deals with a matter relating to the company's ordinary business operations." The purpose of the exception is "to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting.

In this case, the shareholders will need to claim that their proposals are outside the ordinary business, and if refused, may take action through SEC filing.

*The shareholders of Ink have a right under SEC rules to request these additions to the proxy, and the directors may not refuse unless they deem, using the business judgement rule, that the matters are of ordinary business, and thus not appropriate for the proxy and shareholders' vote.*

## **ANSWER 2 (OUTLINE)**

**20% Organization (Similar headings – boldfaced below)**

**20% Issue (Spot all issues)**

**20% Rules (Name all rules – underlined below)**

**20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)**

**20% Conclusions (Provide correct conclusions – as *italicized* below)**

**Issues: derivative action, business judgment rule for directors.**

Under California corporate law, Directors have fiduciary duties to act in good faith and with care. Under section 309, directors must take actions only in the best interests of the corporation.

Business Judgment Rule (BJR), recognized under statute and case law in California, is a presumption that when directors make a decision, they act “on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company”, and the director(s) may not have a financial interest in the outcome.

The burden of proof lies with the shareholders when bringing a derivative action, such that they must overcome the presumption that the directors acted using good business judgement in reaching their decision.

In this case, there are a number of safety and financial “red flags” regarding the target company. The shareholders may use these issues to prove that the directors acted recklessly and thus without judgement.

Depending on the timing, the shareholders may request an injunction to prevent the purchase, or damages if post-purchase. As this is a derivative action brought by the shareholders on behalf of the corporation, any actions or damages belong to the corporation.

*Accordingly, if the shareholders can overcome the presumption of the business judgment rule, they may bring a derivative action against the directors to stop the purchase.*

**ANSWER 3 (OUTLINE)**

**20% Organization (Similar headings – boldfaced below)**

**20% Issue (Spot all issues)**

**20% Rules (Name all rules – underlined below)**

**20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)**

**20% Conclusions (Provide correct conclusions – as *italicized* below)**

**Issues: corporate opportunity, disclosure, director voting**

**Will Tarquin usurp a corporate opportunity by purchasing an interest in Clean**

- California law requires directors to act in the best interests of the corporation and adhere to their fiduciary duties of care and loyalty and avoid self-dealing.
- Corporations have a prior claim to opportunities that are sufficiently connected to the corporation's business, or the acquisition of the opportunity is accomplished through disloyalty and unfairness to the corporation.
- Usurping a corporate opportunity is not permitted without following specific procedures such as disclosure to the board and allowing the board to determine whether to adopt the opportunity. The board may vote, but only disinterested directors' votes will be counted.
- Under California section 310, directors must not engage in an opportunity personally if that opportunity may have a material interest to the corporation.
- In this case, Clean will produce vegetable ink which may be used in the same industries and Ink, and may even substitute and thus overtake Ink's market. Hence, Ink would have a material interest in acquiring the opportunity.
- Tarquin would usurp the opportunity by purchasing an interest in Clean without allowing the corporation the chance to investigate and possibly pursue it.
- In addition, the vegetable ink may have a negative impact on the market for the corporation in that they would be in direct competition.
- Accordingly, Tarquin would violate his duties under Section 310 by not disclosing the opportunity and by not acting in the best interests of the corporation.
- While Tarquin may argue that he found the opportunity while in a personal situation, this argument would fail in light of the close relation to the products of the corporation.
- In order to avoid liability, Tarquin must fully disclose all relevant information to the board and the board must vote whether to adopt the opportunity, or to forfeit it to Tarquin. In the vote, Tarquin's vote would not be counted as he is an interested party and only disinterested directors' votes will be counted.

**What procedure must the board follow under California rules?**

- Under California law, the board may vote to adopt the corporate opportunity, or forfeit it to the interested director.
- Under section 310, only those disinterested directors' votes will be counted, so long as the number of the disinterested directors constitutes a quorum as required by the bylaws.
- In this case, the board must determine whether the opportunity should be adopted by the corporation. In taking the vote, only the five disinterested directors' votes will be counted. As there are ten directors, six would constitute a quorum if the corporation's bylaws define the necessary quorum for such votes as a simple majority.
- *Accordingly the board must vote whether to adopt the opportunity, forfeit it, or possibly take action against the interested director for a violation of his fiduciary duties to the corporation.*

1)

Dear Shareholders,

You have asked me for instructions on how to gain access to Ink's corporate records and how to approach the directors of Ink to add issues to proxies.

### **Access to Corporate Records**

Per California Corporate Code, shareholders have an absolute right to access and copy corporate records for a proper purpose, which may include accounting records (including records of safety and prevention expenditures), records of safety violations, minutes of meetings, lists of shareholder names and addresses, etc.

In order to access Ink's corporate records, you the shareholders, must (1) make a written request on the board of directors asking for the specific records you want access to, (2) state a proper purpose, which here would be to examine Ink's safety and prevention expenditures in light of the recent, large spill into the Salinas river, and (3) allow 5 business days for the corporation to respond. The corporation then has 90 days to provide / allow you access to the information you have requested. If the directors deny your request or the situation is so critical that you cannot wait 90 days or you know that asking the board would be futile, then you can file a derivative action with the Superior Court here in California.

If you are not successful in accessing corporate records, you would be compelled to file a derivative suit. However, 10% of the outstanding shareholders would need to be part of that suit. At the moment you are 25 shareholders out of 10,000 + shareholders, thus you would not meet the threshold necessary to file a derivative suit. Your best option would therefore be, if the company refuses without a valid reason to allow you access to Ink's records, to bring your concerns via proxy to the other shareholders.

Therefore, you have an absolute right to obtain the information you are seeking from Ink.

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### Proxy Request

Per California Corporate Code and statutes, shareholders are allowed to make proxy requests of the board and must do so in writing. These requests must be brought to the directors at least 60 days before the next annual shareholder meeting.

As it is May 1st, you are more than 60 days out from the next annual meeting, thus the timing of your request would be in compliance with California corporations code. Your proxy request should clearly state the nature of the issues you wish to add to next year's proxies. These issues would be (1) that Ink adopts a policy on environmental, social and governance issues (ESG), (2) that it improves its diversity in management, and (3) that Ink address the negative impact of the tank explosion and large spill in the Salinas river. If the board denies your request, you could contact the original founder for their support and also request the names and addresses of the 10,000+ shareholders to reach out directly to them for support on your actions. If your request to have these issues added to next year's proxy vote is denied, you can also file a derivative suit stating that the board is not acting in accordance with their duty of care to the company. However, the Business Judgement Rule's presumption is that the board acts honestly, in good faith, in the best interest and in a reasonable manner on behalf of the corporation. Therefore, you would have to prove that by denying your proxy issues, the board was acting against the best interest of Ink especially in light of the recent large spill in the Salians river and environmental harm that explosion and spill created.

Your best arguments for the inclusion of your issues on the next proxy statement should include that because Ink is the largest supplier of ink to the printing industry as well as other industries, maintaining a safety record and implementing policies to prevent spills such as the tank explosion at the main plant in California which caused a large spill in the Salinas river is in the corporation's best interest as a good corporate citizen. The clean up costs and bad press from such spills would not be in the corporation's best interest and harm the company's reputation. Further, California is an environmental leader state and such spill disasters will cause the state to fine Ink a considerable amount of money, which effects the shareholders' value as owners of the company. Further, Ink is a publicly traded company on the NYSE and environmental disasters hurt stock prices. While the current stock price is \$50 per share, further environmental disasters could potentially reduce Ink's publicly traded value, again harming the owners of the company who the board serves. An environmental, social and governance policy would indicate to existing and potential investors that Ink takes its corporate responsibility and corporate valuation seriously.

A diversity in management would also demonstrate to outstanding and potential shareholders that Ink is a true national company that mimics the diversity of people in the USA. Again this would increase corporate good faith and citizenship as well as have a positive impact on stock valuation.

Therefore, you proxy issues support valid legal concerns for Ink, as the ultimate goal is to prevent future harm to Ink.

Please let me know if we can further assist you in these matters.

Best regards,

P. Stirling

[Organization 19](#)

[Issue 19](#)

[Rule 19](#)

[Analysis/explanation 19](#)

[Conclusion 19](#)

[Total 95](#)

[Excellent! A very clear and concise description that contains all the necessary info for the shareholder to consider in their decision.](#)

2)

Dear Shareholders,

You are asking whether you can stop the acquisition and merger of Ink with Laser, and what responsibilities the directors have to Ink.

### Directors Responsibilities

Under California Corporation Code, directors are agents of the **shareholders** and have a fiduciary responsibility to act in the best interest of the corporation. They owe a Duty of Care and a Duty of Loyalty to the corporation. Under the Duty of Care the Business Judgment Rule presumes that directors act in honest manner, in good faith, in the best interest of the corporation with reasonable care. An honest manner requires the directors to learn about the issues at hand. Under the Duty of Loyalty they must not deal in activities of self-interest while acting as directors, not compete with the corporation while acting as directors, and not act to gain a personal advantage at the financial expense of the corporation.

**Commented [ps1]:** Incorrect. They are agents of the corporation

Here, it is not clear whether the directors carefully examined all available information on the potential acquisition, Laser.

First, Ink specializes in supplying ink throughout the US and they are the largest US ink supplier. While the Articles of Incorporation (AOI) for Ink may or may not have limited Ink's corporate purpose to ink production and distribution, here Laser is a non-ink using company as they manufacture, sell and repair laser printers. Assuming that Ink's AOI defines its business purpose as ink production and distribution, if Ink were to acquire Laser, this would be outside the scope of Ink's business and the directors would breach their Duty of Care to act in the best interest of the company.

Second, Laser has been the defendant in numerous safety issue lawsuits and there are lingering and possible future liabilities. In allowing such an acquisition and merger to be completed, Ink's directors would be acting outside their Duty of Care because they would be opening Ink up to the cost of current and future lawsuits.

Third, the facts do not indicate whether the directors have violated the Duty of Loyalty to the corporation by personal financial gains. But given **the odd choice** of a company to acquire, it is possible.

**Commented [ps2]:** Not so odd as it is somewhat related, but odd if indeed it has liabilities

Given California's corporation codes on director responsibilities, Ink's board has violated their Duty of Care to Ink in seeking to acquire Laser and you have a strong case against the board.

**Commented [ps3]:** Better to say they may have violated their duty as we don't have all the facts re their due diligence

### Shareholder Powers to stop Acquisitions and Mergers

Ultra Vires Action states that when a company operates outside its business purpose as stated in its Articles of Incorporation, the court can stop such an action.

Here, it is clear that laser printer companies do not use ink in their laser printers and ink is **the** product of Ink. Though we have not seen Ink's AOI, Ink's business purpose appears solely to be the supplying of ink. While it is the largest supplier in the US, and it seems reasonable that the board would want to expand Ink's market, to do so legally would require the board to first change the AOI for Ink, which were filed with the Secretary of State of California. Because it appears that the board of Ink did not do so, you the shareholders can file a derivative suit for an **ultra vires action** with the Superior Court in California. The court would then enjoin Ink from acquiring Laser.

**Commented [ps4]:** Good point, but remember the pro forma AOI in California does not limit the type of business

### Fundamental Changes

Under California Corporation Code, the following actions require shareholder approval. These include dissolution of a corporation, acquisitions, mergers and when a corporation substantially sells most of its assets (greater than 75%) which is outside of the normal course of its business.

Here, Ink directors want to acquire Laser. This is a fundamental change to the corporate structure and the directors are not allowed to make this decision alone. As a result they must bring this acquisition to the shareholders for a vote, whereby the majority of shareholders must approve the acquisition. As the board has not done so, I recommend that you shareholders write a letter to the board informing them of their duty to bring this fundamental business issue to the shareholders for a vote. Please reference the above code in your letter. You might also consider sending this same letter to council for Ink as they would also want Ink to comply with California law. This issue can be brought by a Special Proxy vote to the shareholders. Though not likely, but if the directors refuse to put this issue on a proxy for the shareholders to vote, you then need to file a derivative action not only for ultra vires, but also Ink's violation of this California Corporation code.

Given ultra vires action and that this would be a fundamental change to the corporation requiring shareholder voting, you have a strong case in preventing the purchase of Laser.

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Please let me know if I can further assist you in these matters.

Best regards,

P. Stirling

[Organization 19](#)

[Issue 18](#)

[Rule 18](#)

[Analysis 18](#)

[Conclusion 18](#)

[Total 91](#)

[Well done. One item to clarify is the procedure in such an action. The shareholders must request to board to add this to the proxy, if it is not already there. Only if the board refuses, can the shareholders question the judgement of the board by way of a derivative action, overcoming the BJR first.](#)

3)

Dear Tarquin,

### Director's Responsibilities

Under California Corporation Code, directors are agents of the shareholders and have a fiduciary responsibility to act in the best interest of the corporation. They owe a Duty of Care and a Duty of Loyalty to the corporation. Under the Duty of Care the Business Judgment Rule presumes that directors act in honest manner, in good faith, in the best interest of the corporation with reasonable care. An honest manner requires the directors to learn about the issues at hand. Under the Duty of Loyalty they must not deal in activities of self-interest while acting as directors, not compete with the corporation while acting as directors, and not act to gain a personal advantage at the financial expense of the corporation.

#### Duty of Loyalty

This duty requires a director to not take actions in their own best interest at the expense of the company, nor compete with their own company against the company they are a director, nor gain financial advantage at the expense of their own company through insider trading.

Here, you would be taking actions in your own best interest **at the expense of Ink**, because Ink would not have been given this opportunity to invest in Clean. Clean, as a start-up, plans to be in the same or overlapping business as Ink, because they plan to create and produce vegetable dyes and inks for textiles and packaging. Ink supplies ink for printing companies and this probably includes printing on textiles and on packaging as well. Thus the businesses would overlap and be competitors. Also as investor/shareholder in Clean you would directly compete against Clean for the business of printing on textiles and on packaging. This would violate your Duty of Loyalty to Ink.

Therefore, if you invest in Clean, you not only have acted in your self-interest but also would then be competing against Ink.

**Commented [ps5]:** Before concluding this, you should consider Guth and the business line and whether there is an argument that it is not at the expense of ink

## Liabilities

Per California Corporation Code when one or more directors violate their duty of care and duty of loyalty to the corporation, they cannot use the presumption of the Business Judgement Rule (BJR) to protect themselves and will be held jointly and severally liable for an losses to the corporation.

BJR presumes that directors act in the best interest of their companies and do so honestly, in good faith and with reasonable care. However, if you invest in your friend's start-up, without first offering this information to your board, you **would be usurping business that Ink might be interested in** acquiring and you, through your investment, would potentially become a direct competitor of Ink. However, the danger you would face is losing the protection as director of Ink that the presumption BJR affords you. Such a loss of BJR protection would open you up to any and all losses Ink could experience from competing with Clean in the future. While Clean may be a start-up and it might not be conceivable that Clean could really financially hurt Ink, Ink is publicly trading at \$50 per share, it has 10,000 + shareholders, is the largest ink supplier in the US (which is a huge marketshare and thus much to lose) and the recent large spill and resulting environmental damage to the Salinas river from Ink's semi-toxic chemicals, could well be a catalyst for Ink's customers to seek out Clean's environmentally safe vegetable dyes instead.

Therefore, your financial liability could be significant if you invest in your friend's start-up and do not inform Ink's board before you take such an action.

## Prevention

Per California Corporation Code when a director informs the board of a financial opportunity outside the scope of their duties but which overlaps with the corporation's business, the director becomes an interested director and must inform the board of this potential financial opportunity so that the uninterested directors can in honesty exam and using good faith, act in the best interest of the corporation and use reasonable care to determine whether this is an opportunity the corporation should seek or not. Then the action is put to a vote by all uninterested directors (the interested director must abstain from voting) and the majority vote decides the corporation's actions. This process protects the interested director(s) from being held jointly and severally liable to the corporation for any potential losses.

**Commented [ps6]:** May be usurping the board must decide first.

Tarquin, if you inform your board of this opportunity with Clean, provide them with details of the start-up, its potential products and potential customers, then you will have satisfied your Duty of Care as director on Ink's board. Further, this will protect you from the liability of a lawsuit by Ink for breach of your director responsibilities, from financial harm your clandestine investment into Clean could cause Ink and thus you, and you will not have violated California Corporation Code.

In conclusion, as you have not yet committed to Clean, you have not yet violated any duties owed to Ink. Therefore it would be prudent to inform Ink's board before you take further actions with regards to investing in Clean.

Please let me know if I can further assist you in these matters.

Best regards,

P. Stirling

Organization 18

Issue 19

Rule 18

Analysis 18

Conclusion 19

Total 92

Very good. one clarification to bear in mind: the conflicted/interest director does violate their duty of loyalty if the business is in the same line (*Guth*). However, the disinterested directors still need to vote to determine if there is a conflict. It may end up that the disinterested directors decide they are not interested and allow him to go forward and invest.

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**END OF EXAM**