

FIDUCIARY DUTIES OF GOVERNING PERSONS OF BUSINESS ENTITIES

By

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APPENDIX D – Effect of Sarbanes-Oxley Act of 2002 on Common Law Fiduciary Duties

APPENDIX E – Shareholder Rights Plans

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CHAPTER 1. INTRODUCTION.

1.1. General. The following five business entity forms are regularly used for business operations in Texas:

- Corporation
- General Partnership
- Limited Partnership
- Limited Liability Partnership (“LLP”)
- Limited Liability Company (“LLC”)

1.1.1. Choice of Entity. The form of business entity most advantageous in a particular situation depends on the business objectives for which the entity is being organized. In most situations, the choice of entity focus will be on how the entity and its owners will be taxed and the extent to which the entity will shield the owners and managers of the business from liabilities arising out of its activities. An increasingly important factor in choosing the form of entity, and its state of domicile, is the extent to which the fiduciary duties and personal liability of the entity’s board of directors (“Board”) or other governing persons may be limited in the entity’s governing documents.

1.1.2. Entity Governance. The conduct of corporate directors and officers is subject to particular scrutiny in the context of business combinations (whether friendly or hostile), executive compensation and other affiliated party transactions, allegations of illegal or improper

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corporate conduct, and corporate insolvency. The individuals who serve in leadership roles for corporations are fiduciaries in relation to the corporation and its owners.

Increasingly the courts are applying principles articulated in cases involving mergers and acquisitions (“M&A”) to cases involving business opportunities and executive compensation, perhaps because those areas often involve conflicts of interest and self-dealing or because in Delaware, where many of the cases are tried, the same judges are writing significant opinions in both areas. Director and officer fiduciary duties are generally owed to the corporation and its shareholders collectively, but when the corporation is insolvent, the constituencies claiming to be beneficiaries of those duties expand to include the entity’s creditors.

Similar fiduciary principles are applicable to governing persons of a general or limited partnership and a limited liability company (“LLC”). These entities are often referred to as “alternative entities” in recognition that the rights and duties of their owners and governing persons can be modified by contract to greater extent than is permitted in the case of corporations.

1.1.3. State Statutes. The Texas Legislature enacted the Texas Business Organizations Code (the “TBOC”)¹ to codify the Texas statutes relating to business entities referenced above, together with the Texas statutes governing the formation and operation of other for-profit and non-profit private sector entities. The TBOC is applicable to entities formed or converting to another entity form under Texas law after January 1, 2006. Entities in existence on January 1, 2006 could continue to be governed by the Texas source statutes until January 1, 2010, after which time they must conform to the TBOC,² although they could elect to be governed by the TBOC prior to that time.³

Like Texas, Delaware has a body of statutory and case law relating to corporations as well as alternative entities, including partnerships (general and limited) and LLCs. Those statutes include the Delaware General Corporation Law (as amended, the “DGCL”),⁴ the Delaware Revised Uniform Partnership Act (“DRPA”),⁵ the Delaware Revised Limited Partnership Act (“DRLPA”),⁶ and the Delaware Limited Liability Company Act (the “DLLCA”).⁷

1.1.4. Federal Law. The focus of the Congress of the United States (“U.S.”) on how corporations should be governed following corporate debacles early in the last decade led to the

¹ TEX. BUS. ORGS. CODE. ANN. (Vernon 2015), available at www.statutes.legis.state.tx.us/docs/bo/htm/bo.1.htm.

² TBOC § 402.005.

³ TBOC § 402.003.

⁴ DEL. CODE ANN. tit. 8, §§ 101 *et seq.* (Supp. 2015).

⁵ DEL. CODE ANN. tit. 6, §§ 15-101 *et seq.* (Supp. 2015).

⁶ DEL. CODE ANN. tit. 6, §§ 17-101 *et seq.* (Supp. 2015).

⁷ DEL. CODE ANN. tit. 6, §§ 18-101 *et seq.* (Supp. 2015).

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