## TABLE OF CONTENTS

### I. BUSINESS ORGANIZATIONS

#### A. Corporate Law
1. Deal protection measures ......................................................... I-3
2. Demand requirement; fiduciary duties ...................................... I-5
3. Judicial dissolution .................................................................. I-6
4. Piercing the corporate veil ....................................................... I-8

#### B. Limited Liability Company Law
1. Piercing the LLC veil ............................................................... I-10
2. Fiduciary duties ..................................................................... I-11
3. Voluntary withdrawal ............................................................. I-12

### II. COMMERCIAL LAW

#### A. Contracts Generally
1. Choice of forum ..................................................................... I-14
2. “Commercially reasonable efforts” ........................................... I-15
3. Contract manufacturing .......................................................... I-17

#### B. Guarantees
1. Transfer without assignment .................................................... I-18

#### C. Security Agreements
1. Public sale of collateral ............................................................ I-20

### QUESTIONS

.......................................................... I-23
ACKNOWLEDGMENTS

The materials in this manuscript largely are excerpted from:


My thanks to Nathan Standley (Elon Law ’11) for his help with this manuscript.
I. BUSINESS ORGANIZATIONS
   A. Corporate Law
      1. Deal protection measures

*Shareholder approval not required for share exchange involving issuance of new shares only.* Share exchange giving acquirer 40% of voting rights not coercive, but not allowing redemption by target for 18 months after shareholder vote improper impediment to performance of board duties. Limited fiduciary duty out requiring submission to shareholder vote, but allowing board to withdraw recommendation, not coercive or improper impediment to performance of board duties.

In the midst of the financial crisis that erupted in late 2008, the North Carolina Business Court considered whether a share exchange involving the issuance of new shares required shareholder approval and whether certain deal protection measures approved by the directors in a merger were coercive or prevented the directors from performing their duties. *Ehrenhaus v. Baker,* 2008 NCBC 20 (December 5, 2008). The court held that no shareholder approval of the share exchange was required under N.C. Gen. Stat. §§ 55-11-02 and 55-11-03 because it was not a compulsory exchange of existing and outstanding shares. In addition, the court held that a share exchange giving an acquirer 40% of a target’s voting rights was not coercive, but not allowing redemption of those shares for 18 months after a shareholder vote impeded the ability of the directors to perform their duties. Finally, the court determined that a provision requiring the board to submit the merger to a shareholder vote, but allowing the board to withdraw its recommendation and to entertain superior offers, was not coercive.

Following a whirlwind of events in the wake of the financial crisis, the board of directors of Wachovia Corporation approved a merger agreement with Wells Fargo & Company. In an attempt to assure the market of the transaction’s ultimate success, the parties agreed to a separate share exchange under which Wells was granted Wachovia preferred stock representing 39.9% of the aggregate voting rights of Wachovia in exchange for Wells common stock. The preferred stock granted to Wells was not redeemable for 18 months after the proposed shareholder vote on the merger. In addition, the merger agreement required Wachovia to put the merger to a shareholder vote even if its board later determined, due to the presence of a superior proposal, that recommending the merger would violate its fiduciary duties (the “limited fiduciary out”).

A Wachovia shareholder sued Wachovia and its directors seeking to preliminarily enjoin the merger. The plaintiff claimed that (i) the share exchange violated N.C. Gen. Stat. §§ 55-11-02 and 55-11-03 because it was effected without shareholder approval, (ii) the share exchange was coercive; (iii) the limited fiduciary out prevented the directors from exercising their fiduciary duties and (iv) the board was not attentive and informed in negotiating the deal protection measures.

The Business Court first determined that the share exchange did not violate N.C. Gen. Stat. §§ 55-11-02 and 55-11-03. According to the court, those statutory provisions
The court considered the claim that the Wachovia directors had breached their fiduciary duties by approving the merger agreement and the share exchange. Noting that all but one of the directors were outside directors, the court dismissed the plaintiff’s charge that the board breached its duty of loyalty by approving a transaction in which some senior executives stood to receive substantial “change in control” or “golden parachute” payments. As to whether the board was attentive and informed, the court recited the extraordinary circumstances surrounding the transaction and observed that management had kept the board fully apprised of the facts, that the board met many times and understood the substantive terms of the merger agreement, including its deal protection measures, and that the directors had received advice from counsel and financial advisors. According to the court, therefore, the plaintiff could not rebut the presumption afforded by the business judgment rule that the board had discharged its duties under N.C. Gen. Stat. § 55-8-30 by acting with due care and in good faith in the honest belief that its action was in the best interest of the corporation.

Having concluded that the facts did not evidence a breach of fiduciary duty, the Business Court turned to the question of whether the share exchange or the limited fiduciary out was coercive or prevented the directors from continuing to exercise their fiduciary duties. The court recognized that Wells’s holding approximately 40% of the Wachovia voting rights almost assured approval of the merger, but determined that it was not actionably coercive because it “literally” did not give Wells the majority of votes required to approve the merger. Likewise, the court decided that the limited fiduciary out was not actionably coercive and did not “impermissibly abrogate” the board’s continuing “fiduciary obligations to the Wachovia shareholders” because the board could entertain third-party solicitations and implicitly oppose the Wells merger by withdrawing its recommendation and explaining why. Moreover, the court observed that neither measure prevented the shareholders from pursuing other offers because no other offers were outstanding or expected.

One of the deal protection measures – the 18-month no-call period for the Wachovia preferred shares issued to Wells – did not survive. This 18-month tail, according to the court, would prevent the board from fulfilling its fiduciary duties in the event the shareholders did not approve the merger because it would impede the board’s ability to court another merger partner.

* * *

govern compulsory exchanges of shares that are existing and outstanding. The shares issued to Wells were newly issued, and no shareholder was compelled to exchange outstanding shares. Therefore, a shareholder vote was not required by statute.
2. Demand requirement; fiduciary duties

*Demand reciting only shareholder harms sufficient to meet derivative suit demand requirement when alleged harms also form basis for derivative claims. No direct cause of action against directors for breach of fiduciary duty.*

The North Carolina Business Court considered whether a demand letter was sufficient to meet the demand requirement under N.C. Gen. Stat. § 55-7-42 when the letter only recited violations of shareholder rights and whether a shareholder has a direct cause of action against a director for breach of fiduciary duty. *Green v. Condra,* 2009 NCBC 21 (August 14, 2009). The court concluded that a demand letter reciting only violations of shareholder rights is sufficient when those violations also form the basis of the derivative claims. Additionally, the court determined that, because fiduciary duties generally are owed to the corporation and not shareholders, shareholders do not have a direct claim for breach of fiduciary duty. The court considered these issues in the context of a motion to dismiss and therefore assumed the facts alleged in the complaint, and described below, to be true.

Plaintiffs W. Greg Green and Kenneth Ellington, M.D. were shareholders of MedOasis, Inc., a corporation Green formed in 2001 to provide billing and collection services to Asheville Anesthesia Associates (“AAA”) and other anesthesiology practices. Ellington received shares in MedOasis because he was an AAA physician. Green and Ellington together owned 226,000 shares of MedOasis.

Green and Ellington were removed from the MedOasis board in 2005 and, following their removal, MedOasis increased the number of authorized shares from 1,000,000 to 1,500,000 and the board adopted new bylaws. MedOasis terminated its service agreement with AAA in May 2008 and notified Ellington that, under the corporation’s bylaws, his shares were subject to redemption as a result. Other MedOasis shareholders receiving similar notices granted Ellington proxies for a total of 481,000 shares in July 2008, thereby giving Green and Ellington the power to vote 707,000 of MedOasis’s 1,147,109 outstanding shares. MedOasis directors controlled the other 440,109 shares.

MedOasis had not held a shareholders’ meeting in quite some time, and in August 2008, Green demanded that MedOasis hold a meeting to amend the corporation’s bylaws, to remove one or more directors and to elect a new board. In response, the board met and determined that Ellington did not have the right to vote his shares or those for which he held proxies. The board also authorized the corporation to issue, for a price alleged to be “well below their market value or fair value,” 280,000 shares to Ken Condra and Daniel Prevost, both of whom were directors of MedOasis. That issuance gave the board control of a majority of the corporation’s shares.

MedOasis held the shareholders’ meeting later in August. Ellington was not permitted to vote his shares or those for which he held proxies, but Condra and Prevost
were allowed to vote the 280,000 shares newly issued to them. Consequently, both Green’s bylaws amendment and the proposal to remove members of the board failed. No vote to elect a new board was held. After the meeting, Green and Ellington made a written demand that MedOasis take action with respect to alleged wrongs committed by the board before and during the shareholders’ meeting. MedOasis did not respond to the demand, and Green and Ellington sued, alleging direct and derivative claims for, among other things, breach of fiduciary duty.

As to the derivative claims, the defendants asserted that the plaintiffs did not make a proper demand on MedOasis under N.C. Gen. Stat. § 55-7-42 prior to filing the lawsuit. According to the defendants, the plaintiffs’ demand was deficient in that it only alleged how the plaintiffs were treated unfairly, not the specific derivative causes of action that the plaintiffs claimed in the lawsuit. The court rejected the defendants’ argument, deciding instead that the plaintiffs’ demand met the statutory requirements because it summarized acts on which the derivative claims were based.

The plaintiffs’ direct claims were based on allegations that the defendants breached their fiduciary duties by engaging in a deliberate plan to dilute the plaintiffs’ ownership interests, to squeeze them out and to maintain control of MedOasis. The court noted that directors generally owe fiduciary duties to the corporation and not the shareholders and therefore claims for breach of fiduciary duty usually are derivative, not direct, claims. Rather than dismissing the plaintiffs’ direct claims on that basis, however, the court recast them, stating that “a claim should not be dismissed . . . merely because it is mislabeled so long as the factual allegations give rise to a claim under some valid legal theory.” The court determined that the essence of the plaintiffs’ direct claims was the denial by the board of the plaintiffs’ right to vote their shares. According to the court, because that right is specifically recognized by statute, the plaintiffs had properly alleged direct claims for statutory violations of their right to vote their shares.

* * *

3. Judicial dissolution

Unfair dilution of minority interest is breach of fiduciary duty and grounds for judicial dissolution, but terminating employment of shareholder is neither if continuing employment threatens corporation and shareholder contributed to circumstances resulting in threat.

The North Carolina Business Court considered whether the firing of two shareholders of a close corporation and the subsequent dilution of their ownership interests were grounds for judicial dissolution. Vernon v. Cuomo, 2009 NCBC 6 (March 17, 2009). The court concluded that dilution through self-dealing supports dissolution, but that termination of employment does not when continuing employment threatens the survival of the corporation and the terminated shareholders giving rise to circumstances contributing to the threat.
Paul Vernon, Joel Williams, Vinay Sakhrani, Jerome Cuomo, Charles Tomasino, Charles Chiklis and Robert Mineo were shareholders of TriboFilm Research, Inc., a corporation formed to develop syringe and optical lens coatings. After maintaining good working relationships for a number of years, a series of disagreements and a lack of communication among the parties made the corporation dysfunctional and led Vernon and Williams to file a lawsuit against Sakhrani, Cuomo, Tomasino, Chiklis and Mineo.

At a November 2005 special board meeting, the defendants, representing a majority of TriboFilm’s directors, removed the plaintiffs as officers of the corporation and terminated their employment. Then, at a special shareholders’ meeting, the defendants, representing a majority of the outstanding shares of TriboFilm, removed the plaintiffs from the board.

In June 2006, the defendants, as the only members of TriboFilm’s board, authorized a significant salary increase for Sakhrani, the payment for the first time of salaries to the other defendants and a deferral of the defendants’ salaries. In December 2006, the board approved the conversion of a portion of the deferred salaries into TriboFilm stock. The board did not disclose any of these actions to the plaintiffs when it recommended to the shareholders an amendment of the corporation’s articles to increase the number of authorized shares. The shareholders approved the amendment, notwithstanding the plaintiffs’ objections. The corporation then converted the deferred salaries into Tribofilm stock as planned, reducing each plaintiff’s ownership interest in TriboFilm from 20.2% to 2.4%.

N.C. Gen. Stat. § 55-14-30(2)(ii) provides that a “superior court may dissolve a corporation . . . in a proceeding by a shareholder if it is established that . . . liquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder.” Under Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983), whether liquidation is reasonably necessary for that purpose depends on whether the reasonable expectations of the complaining shareholder or shareholders have been frustrated.

The Business Court determined that the plaintiffs initially had a reasonable expectation of continuing employment at TriboFilm, but that the “expectation ceased to be reasonable when the [c]ompany and the relationships among the shareholders became dysfunctional.” According to the court, even if an expectation of continued employment was reasonable at some point, a corporation is not required to fulfill that expectation if doing so threatens the well-being of the corporation. The court concluded therefore that the defendants had not breached any fiduciary duty when they fired the plaintiffs. The court acknowledged that, in certain circumstances, such a termination can support a claim for dissolution, but concluded that terminating the plaintiffs’ employment with TriboFilm did not because they had contributed to the turmoil that led to their termination.

The court determined that the plaintiffs also had reasonable expectations of maintaining their relative ownership interests in TriboFilm. The defendants, the court
found, engaged in self-dealing when they diluted those interests and, under N.C. Gen. Stat. § 55-8-31, had the burden of showing that the transactions were fair to the corporation because the self-dealing transactions were not approved by disinterested directors or shareholders to whom the material facts were disclosed. According to the court, the defendants did not meet their burden because they were the sole beneficiaries of the exchange of the deferred salaries for TriboFilm stock and had approved the salary deferrals when the corporation was unable to pay those obligations. This, the court asserted, “clearly” indicated that the primary purpose of the exchange was dilution of the plaintiffs’ interests. The defendants therefore had breached their fiduciary duties to the corporation and the plaintiffs. That breach, according to the court, justified an order of dissolution under N.C. Gen. Stat. § 55-14-30(2)(ii). Consequently, the court set aside the dilution of the plaintiffs’ interests and ordered that the corporation be dissolved. Following the order, TriboFilm had 10 days to notify the court if it elected to purchase the plaintiffs’ shares for fair value in accordance with N.C. Gen. Stat. § 55-14-31(d).

* * *

4. Piercing the corporate veil

“In reverse-piercing” is valid substantive claim in North Carolina.

The North Carolina Court of Appeals held that “reverse veil piercing” is a valid substantive claim in North Carolina. Fischer Inv. Capital, Inc. v. Catawba Dev. Corp., No. COA08-1407, 2009 WL 3617480 (N.C. Ct. App. November 3, 2009). The court considered the issue in the context of a motion to dismiss and therefore assumed the facts alleged in the complaint, and described below, to be true.

Mark Lewis was a guarantor of a loan made by Fischer Investment Capital, Inc. to HCL Partnership, LLP. Fischer also had made a loan to Catawba Development Corporation, a corporation in which Lewis owned 99% of the stock and his wife owned the remaining 1%. The loan to Catawba was secured by a deed of trust encumbering the approximately 77-acre “Grovestone Property”.

Both HCL and Catawba defaulted on their loans from Fischer. Fischer was planning to foreclose on the Grovestone Property when Lewis indicated that Catawba would “refinance” the Catawba loan. Catawba then transferred the property to Ridgeline Real Estate Corporation, a corporation controlled by Lewis’s wife, and made a large payment on the Catawba loan. The payment did not satisfy the loan in full, so Catawba, Lewis and two others delivered to Fischer a new, smaller, unsecured note.

Fischer sued and obtained a default judgment against Lewis with respect to his liability for the HCL loan and, following default on the new Catawba note, obtained a default judgment against him with respect to that debt as well. Then, to reach the Grovestone Property to satisfy Lewis’s obligations with respect to the HCL loan, Lewis
sought to pierce Catawba’s corporate veil and to have the court set aside Catawba’s transfer of the Grovestone Property to Ridgeline.

Normally, a plaintiff desires to pierce the corporate veil in order to hold a dominant shareholder liable for the debts of a corporation. Fischer, however, sought “reverse-piercing” – to pierce Catawba’s corporate veil in order to hold Catawba liable for the debts of Lewis, its dominant shareholder.

The Court of Appeals noted that it had approved “reverse-piercing” in Strategic Outsourcing, Inc. v. Stacks, 176 N.C. App. 247, 625 S.E.2d 800 (2006). Lewis’s wife and Ridgeline, defendants in the case, contended however that allowing Fischer to pierce Catawba’s corporate veil would impose liability on a corporation “not directly involved in the transaction from which the underlying claim arises.” This, they claimed, was inconsistent with previous North Carolina appellate decisions. In support of their argument, Lewis’s wife and Ridgeline pointed to Statesville Stained Glass, Inc. v. T.E. Lane Construction & Supply Co., 110 N.C. App. 592, 430 S.E.2d 437 (1993), and Cherry v. State Farm Mutual Automobile Insurance Co., 162 N.C. App. 535, 590 S.E.2d 925 (2004). The Court of Appeals distinguished both cases. As to Statesville Stained Glass, the court observed that the plaintiff in that case failed, not because North Carolina did not allow piercing the veil of a corporation not directly involved in the activity complained of, but because the plaintiff did not have sufficient evidence to support its claims. The court noted that, in Cherry, piercing the corporate veil would have imposed liability on a corporation “not in any way involved” in the alleged wrong. Unlike Cherry, the court maintained, all of the defendants involved in the Fischer Inv. Capital case were alleged to have participated in the conduct on which Fischer’s claim was based (i.e., the conveyance of the Grovestone Property to Ridgeline).

In addition, Lewis’s wife and Ridgeline asserted that North Carolina either does not or should not “recognize ‘reverse veil piercing’ outside the personal jurisdiction context.” The Court of Appeals rejected that argument as well and indicated that, although the prior cases dealing with “reverse-piercing” arose in the context of personal jurisdiction, “the theory upon which [the court had] sustained an assertion of personal jurisdiction over the corporate defendant [in those cases] was identical to the substantive theory upon which the plaintiff relied.” The court therefore concluded that “reverse-piercing” is a valid substantive claim in North Carolina.

* * *
B. Limited Liability Company Law

1. Piercing the LLC veil

Member of LLC not a “new” party for purposes of statute of limitations if veil of LLC is pierced.

The North Carolina Supreme Court considered whether an applicable statute of limitations barred a claim against a member of a North Carolina limited liability company when the original complaint named only the company and was amended to add the member after the statute had run. *State v. Ridgeway Brands Manufacturing, LLC*, 362 N.C. 431, 666 S.E.2d 107 (2008). The Supreme Court concluded that, if a plaintiff is successful in piercing the veil of a limited liability company, a member of that limited liability company who later is added as a party in the litigation is not a “new” party for purposes of determining whether a claim is barred by a statute of limitations.

In May 2004, the State of North Carolina filed a lawsuit against Ridgeway Brands Manufacturing, LLC, a North Carolina limited liability company, to recover funds Ridgeway was required to deposit in a statutory escrow in 2004, together with related civil penalties. In October 2005, the State filed an amended complaint that, among other things, sought to impose liability on James C. Heflin and others under a “piercing the corporate veil” theory. Heflin was a member-manager of Ridgeway.

The trial court dismissed the claims against Heflin for piercing the corporate veil and for the civil penalties. The North Carolina Court of Appeals reversed the trial court’s decision as to the piercing the corporate veil claim, but determined that the applicable statute of limitations barred assessment of the civil penalties against Heflin because the amended complaint added him as a party and the “relation-back” doctrine (under which an amendment is treated as being made at the time of the original filing) did not apply to “new” parties. The North Carolina Supreme Court reversed the decision of the Court of Appeals and concluded that Heflin would not be a “new” party if he were determined to be an alter ego of Ridgeway under the piercing the corporate veil theory. If Heflin were not a “new” party, the “relation-back” doctrine would apply and the State’s claim for the civil penalties could proceed.

In reaching its decision, the Supreme Court examined its prior jurisprudence with respect to piercing the corporate veil, noting that North Carolina applies the “instrumentality rule” adopted in *Glenn v. Wagner*, 313 N.C. 450, 329 S.E.2d 326 (1985). Citing *Henderson v. Sec. Mortgage & Fin. Co.*, 273 N.C. 253, 160 S.E.2d 39 (1968), the court explained that, under the instrumentality rule, a corporate entity is disregarded if it is a mere instrumentality or alter ego of the sole or dominant shareholder and limiting the liability of the shareholder through the corporate form would violate North Carolina public policy or statutory law. Applying these principles to the facts alleged by the State, the court concluded that the State’s pleadings were sufficient to support a claim that Ridgeway was such an instrumentality of Heflin. As a result, the
State could add Heflin as a party for purposes of the civil penalties, contingent on the State’s success in establishing Ridgeway as Heflin’s alter ego.

Interestingly, the Supreme Court’s opinion seems to ignore the fact that Ridgeway was a limited liability company and not a corporation. Throughout its analysis, the court uses the terms “corporation” and “shareholder” rather than “limited liability company” and “member,” thereby implying that traditional piercing the corporate veil principles clearly apply equally to limited liability companies. In In re DePaulis, 2008 WL 4446999 (W.D.N.C. 2008), the United States District Court for the Western District of North Carolina stated that it was unaware of any cases under North Carolina law deciding that the “instrumentality rule” applied to limited liability companies. State v. Ridgeway Brands Manufacturing, LLC now is such a case.

2. Fiduciary duties

Members of LLC generally do not owe fiduciary duties to each other.

The North Carolina Court of Appeals considered whether members of a North Carolina limited liability company owe fiduciary duties to each other. Kaplan v. O.K. Technologies, L.L.C., ___ N.C. App. ___, 675 S.E.2d 133 (2009). The court confirmed that members of a North Carolina limited liability company generally do not.

Kaplan and three other individuals were the members of O.K. Technologies, L.L.C., a North Carolina LLC that held intellectual property relating to aquarium components. The LLC’s operating agreement provided that all of the members were managers. Kaplan owned a 41.5% membership interest and was the company’s sole source of funding. Under the company’s operating agreement, Kaplan was to make loans to the company totaling $500,000. Without seeking approval from the other members, however, he loaned the company $1,864,749 between 2004 and 2006. Even though the other members had not approved the additional loans, the company and the members accepted the loans and used them to discharge the company’s liabilities.

In June 2006, Kaplan demanded repayment of his loans. Following his request, in July 2006, all of the members voted to dissolve O.K. Technologies. Shortly thereafter Kaplan sued the LLC and the other members, seeking a declaratory judgment that the company failed to repay his loans. The other members of the company counterclaimed, alleging that Kaplan had breached his fiduciary obligations to them.

In its opinion, the Court of Appeals noted that the North Carolina Limited Liability Act does not recognize fiduciary duties among members of an LLC. Members “are like shareholders in a corporation in that members do not owe a fiduciary duty to each other or to the company.” The court added, however, that a fiduciary relationship might exist if a member controls an LLC. Nevertheless, because Kaplan owned only a
41.5% membership interest, the court found that he lacked control of the company and therefore owed no fiduciary duty based on his membership interest in the LLC.

The court then examined whether Kaplan owed a duty to the other members in his role as the company’s sole investor. The other members contended that Kaplan “made himself the sole source of funding for O.K., which resulted in the level of domination contemplated by our Courts in defining a fiduciary relationship.” Again, the court disagreed. It found that the operating agreement, to which all of the company’s members consented, contemplated that Kaplan would be the sole source of funding for the company. Based on this fact and Kaplan’s lack of actual domination over the company’s operation, the court concluded that “without more, we cannot find that Kaplan’s status as O.K.’s sole investor creates a fiduciary relationship.”

Finally, the Court considered the other members’ claim that the relationship between members of a closely-held LLC is like the fiduciary relationship between partners in a partnership. The Court rejected this argument because, as permitted by statute, the company’s operating agreement eliminated the personal liability of all managers (including Kaplan) except in certain instances. The Court stated that even if an exception applied, Kaplan’s fiduciary duty as a manager was to the LLC and not to the other members. O.K. Technologies was not an appellant in the case; therefore, the Court refused to address Kaplan’s potential liability to the company.

* * *

3. Voluntary withdrawal

Voluntary withdrawal permitted only if in articles of organization or written operating agreement.

The North Carolina Business Court considered, in a case of first impression, whether a member of a North Carolina limited liability company can withdraw voluntarily in the absence of a provision in its articles of organization or a written operating agreement allowing voluntary withdraw. Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC v. Brewer, 2009 NCBC 10 (March 31, 2009). The court held that a member only may withdraw to the extent provided in the LLC’s articles or a written operating agreement.

The plaintiffs and the defendants in the case were members of Mitchell, Brewer, Richardson, Adams, Burge & Boughman, PLLC (the “Firm”), a law firm organized as a North Carolina professional limited liability company, which just like any other North Carolina LLC is formed under and subject to the North Carolina Limited Liability Company Act. In June 2005, the plaintiffs stopped practicing law with the Firm and started their own firm. At that time, the Firm had a number of unresolved contingent fee engagements. Some of the engagements remained with the Firm after the plaintiffs departed; others transferred to the plaintiffs’ new firm. The lawsuit before the Business
Court arose because the parties disagreed on whether legal fees from contingent fee engagements that remained with the Firm should be shared. The extent to which such fees would be shared depended on the effect of the plaintiffs’ ceasing to practice with the Firm.

The plaintiffs claimed that, as a result of their ceasing practice with the Firm, the Firm should be treated as having dissolved. If the Firm were dissolved, the plaintiffs contended, they would share in distributions related to the contingent fee cases retained by the Firm through the winding up process.

The defendants asserted, on the other hand, that when the plaintiffs stopped practicing with the Firm, they voluntarily withdrew from the LLC and therefore were entitled under N.C. Gen. Stat. § 57C-5-07 to receive the fair value of their interests in the Firm as of the date of the withdrawal. The defendants further claimed that the fair value of those interests did not include any value related to the contingent fee cases the Firm retained because the outcomes of those cases were so uncertain that their value was impossible to quantify.

The Firm never had a formal written operating agreement. As a result, the Business Court turned to the LLC Act to determine the effect of the plaintiffs’ departure from the Firm. After considering the parties’ arguments, the court decided that neither “the spirit [n]or letter of the [LLC] Act” addressed the facts in the case. Its opinion, however, only described its rationale for why a withdrawal under the LLC Act was not supported by the facts; it did not discuss in any detail the question of dissolution.

N.C. Gen. Stat. § 57C-5-06 provides for voluntary withdrawal “only at the time or upon the happening of the events specified in the articles of organization or written operating agreement,” and the Court concluded that N.C. Gen. Stat. § 57C-5-06 is the exclusive means for voluntary withdrawal from an LLC. Therefore, because the Firm’s articles of organization did not provide for voluntary withdrawal, voluntary withdrawal only was possible if the Firm had a written operating agreement that provided for it. The defendants urged that a combination of conduct, writings and e-mails relating to the plaintiffs’ departure from the Firm constituted a binding written operating agreement that addressed voluntary withdrawal and that under the terms of that operating agreement the plaintiffs had withdrawn. While acknowledging that a collection of documents might be a considered a written operating agreement under certain circumstances, the court determined this case did not present those circumstances.

Having determined that it could not use the LLC Act to resolve the case, the Business Court turned to the law of estoppel and determined that, because of numerous statements the plaintiffs had made indicating that they were withdrawing and because the parties acted as though the plaintiffs had withdrawn, the plaintiffs were estopped from denying that they had withdrawn.

***
II. COMMERCIAL LAW

A. Contracts Generally

1. Choice of forum

*Forum selection clause in contract not entered into in North Carolina enforceable by nonsignatory if compelling reasons do not dictate otherwise.*

The North Carolina Business Court considered whether a forum selection clause designating foreign venue contained in a contract not entered into in North Carolina is enforceable by a nonsignatory under North Carolina law. *Speedway Motorsports Int’l Ltd. v. Bronwen Energy Trading, Ltd.*, 2009 NCBC 3 (February 18, 2009). Relying on common law principles previously applied to arbitration clauses, the court held that a nonsignatory may enforce a forum selection clause. In addition, drawing on previous appellate rulings, the court affirmed that a forum selection clause in a contract not entered into in North Carolina is valid unless “compelling reasons dictate otherwise.”

Swift Aviation Group, Inc. required financing in order to perform its obligations under contracts for the purchase, loading and delivery of petroleum products. BNP Paribas S.A. agreed to provide financing to Swift, but only if Swift engaged Bronwen Energy Trading, Ltd. to assist Swift with the petroleum contracts. Swift agreed and entered into a series of contracts with Bronwen that were addressed to and approved by, but not signed by, Paribas. The Swift/Bronwen agreements included forum selection clauses providing that “disputes arising under [the agreements] or in connection with [the agreements] shall be exclusively submitted to the commercial court of Paris, France.”

The Business Court’s opinion deals with claims by Swift, one defendant, against Paribas, another defendant, for breach of fiduciary duty and fraud based on representations Paribas made as to Bronwen. Citing the forum selection clauses in the Swift/Bronwen agreements, Paribas moved to dismiss Swift’s claims for improper venue. The Business Court determined that the forum selection clauses were enforceable by Paribas and granted Paribas’ motion.

The court evaluated the enforceability of the forum selection clauses under North Carolina law, notwithstanding choice of law provisions in the Swift/Bronwen agreements designating French law as the governing law. The court noted that, while a choice of law provision generally will be valid in North Carolina and the law chosen usually governs contract interpretation, the parties in this case did not provide authority or evidence to enable the court to apply French law. Therefore, based on North Carolina Rule of Civil Procedure 44.1 and cases interpreting the analogous federal rule, the court concluded that it need not apply French law and could apply North Carolina law instead.

The court then turned to the forum selection clauses and acknowledged that, for contracts entered into in North Carolina, N.C. Gen. Stat. § 22B-3 generally voids clauses designating venue in another state. According to the court, however, the statute did not apply in this case because the parties did not claim that the agreements were entered into...
in North Carolina. Therefore, based on the decisions of the North Carolina Court of Appeals in *Credit Leasing, Inc. v. D.J.’s of Salisbury, Inc.*, 140 N.C. App. 521, 537 S.E. 2d 227 (2000), and the North Carolina Supreme Court in *Perkins v. CCH Computax*, 333 N.C. 140, 423 S.E.2d 780 (1992), the forum selection clauses in the Swift/Bronwen agreements were valid unless “compelling reasons dictate[d] otherwise.”

The Business Court found no such compelling reasons. The court rejected Swift’s argument that the forum selection clauses could not be enforced by Paribas because Paribas was not a party to the Swift/Bronwen contracts. In reaching its conclusion, the court looked to common law principles that allow for enforcement of arbitration provisions by persons who are not contract parties and extended those principles to forum selection clauses based on the North Carolina Supreme Court’s strong statement in *Perkins* that forum selection clauses are enforceable. In reaching its decision, the court emphasized Paribas’ role in the Swift/Bronwen agreements and focused on the fact that the agreements included unconditional obligations of both Swift and Bronwen to Paribas and specified Paribas’ contractual rights against both.

In addition, the Business Court dismissed Swift’s argument that the forum selection clauses did not apply to its tort claims against Paribas because the claims were unrelated to the Swift/Bronwen agreements. Swift had attached and quoted extensively from the agreements in its answer and, according to the court, the broad forum selection clauses “easily encompass[ed] [Swift’s] tort claims because they [had] their genesis in the [Swift/Bronwen agreements] and related petroleum contracts.”

Finally, the court refused to accept Swift’s argument that, because the Swift/Bronwen agreements were “wholly one-sided” and Swift was forced to enter into them, enforcing the forum selection clauses was contrary to North Carolina public policy. Although the court acknowledged that Paribas had “substantial rights” under the agreements, it concluded that the agreements themselves were not fraudulent or overreaching. Moreover, finding no authority that a forum selection clause is invalid because of substantial differences in discovery rules, the court rejected Swift’s argument that forcing it to litigate in a French commercial court, where discovery is more limited, was “unreasonable and unfair.”

* * *

2. “Commercially reasonable efforts”

“Commercially reasonable efforts” determined in reference to industry standards, not past practices.

The North Carolina Business Court considered what standard applies to measure the efforts of a party to a contract when the party has agreed to use “its commercially reasonable efforts” to achieve a desired end. *Lexington Furniture Industries, Inc. v. Bob Timberlake Collection, Inc.*, 2009 NCBC 22 (September 9, 2009). The court
concluded that, in such a case, a party’s efforts are measured against an objective standard based on industry practices.

In 1991, Lexington Furniture Industries, Inc. and The Bob Timberlake Collection, Inc. entered into a license agreement under which Lexington was to have the exclusive right to use Timberlake trademarks in connection with the production, marketing and sale of two furniture collections. The agreement granted Lexington broad discretion regarding the production, marketing and distribution of the collections, but also required Lexington to use “its commercially reasonable efforts in the manufacture, sale, promotion, advertisement, and marketing of the [collections] to exploit the rights granted” in the agreement.

In 2008, Timberlake notified Lexington that Timberlake intended to terminate the license agreement because Lexington had breached its obligation to use “its commercially reasonable efforts” as required by the agreement. Lexington then filed a declaratory judgment action in which it asked the Business Court to declare that it had not breached the license agreement and that it remained in force.

In the lawsuit, Timberlake claimed that, because the term “commercially reasonable efforts” was modified by the word “its,” Lexington’s efforts to produce, market and sell the Timberlake collections must be measured against Lexington’s past practices with respect to those collections. Lexington, to the contrary, argued that the proper measure of its performance was an objective standard based on industry practices.

The Business Court adopted the standard advocated by Lexington, noting that the standard proposed by Timberlake was unreasonable because it would require Lexington to use the same strategies to market the Timberlake collections in 2008 that it had used in 1991. The court observed that, if Timberlake’s proposed standard were the proper measure, the use of the internet and new furniture shows would not be consistent with the requirements of the agreement. Furthermore, according to the court, if Timberlake wished for Lexington to act in accordance with past practices, it could have negotiated specific language in the license agreement to require that. The court interpreted the word “its” when modifying “commercially reasonable efforts” as merely identifying the party responsible for making the efforts. Moreover, according to the court, even if “its” meant something more, it only “suggest[ed] a measure of commercial reasonableness given Lexington’s size and circumstances.”

* * *
3. Contract manufacturing

Coordination of supply contract and supplier’s awareness of contract manufacturing agreement not sufficient to make purchaser of manufactured product a third-party beneficiary of supply contract.

The North Carolina Court of Appeals considered whether a purchaser in a contract manufacturing arrangement could recover against one of the contract manufacturer’s suppliers as a third-party beneficiary of the supply contract. Hospira Inc. v. AlphaGary Corp., ___ N.C.App. ___, 671 S.E.2d 7 (2009). The court held that coordination of a contract between the manufacturer and the supplier and the supplier’s awareness of the contract manufacturing arrangement alone are not sufficient to support a third-party beneficiary breach of contract claim; “active and direct dealings” are required.

Hospira Incorporated makes medical devices known as sight chambers that allow monitoring of fluids in intravenous lines. To produce the sight chambers, Hospira uses a specially formulated “radiation grade” material known as ADB that it converts into pellets in its manufacturing process. In 1999, Hospira contracted with Moll Industries, Inc. to manufacture its sight chambers and provided Moll with ADB pellets for that purpose. In 2001, Hospira engaged AlphaGary Corporation to pelletize ADB and AlphaGary signed a specification letter under which AlphaGary guaranteed that the pellets would be manufactured in accordance with Hospira’s specifications. Also, Hospira again contracted with Moll in 2001 to manufacture its sight chambers. This time, however, Hospira did not provide Moll with ADB pellets, but told Moll to purchase the pellets from AlphaGary. Moll did so, but the pellets AlphaGary supplied to Moll were made from non-radiation grade material.

The sight chambers produced by Moll with AlphaGary’s pellets started becoming severely discolored after repeated sterilization. As a result, Hospira filed a lawsuit against AlphaGary asserting claims of third-party beneficiary breach of contract, negligence, fraud, negligent misrepresentation and unfair and deceptive trade practices. The North Carolina Business Court granted summary judgment to AlphaGary with respect to the third-party beneficiary breach of contract claim and all of the other claims, except for the negligence claim which it had previously dismissed. The Court of Appeals affirmed the Business Court’s grant of summary judgment with respect to the third-party beneficiary breach of contract claim and the other claims, but reversed its dismissal of the negligence claim.

The Court of Appeals concluded that Hospira could not establish a third-party beneficiary breach of contract claim because the evidence merely suggested that Hospira coordinated the contract between Moll and AlphaGary and that AlphaGary knew about the contract manufacturing arrangement between Hospira and Moll. The court observed that all communications regarding the supply of pellets to Moll were between AlphaGary and Moll and therefore did not show that Hospira was actively and directly involved in
the contract. The court added that the breach of contract claim was not viable for another reason – any benefits accruing to Hospira were by their nature indirect.

As to Hospira’s fraud claim, the court noted that, in order to establish a claim for fraud, a false representation or concealment must be made to the party claiming fraud. In this case, the court concluded, the specification letter that AlphaGary signed for Hospira did not apply to transactions between Moll and AlphaGary and therefore AlphaGary did not make any false representation to Hospira with respect to the Moll-manufactured sight chambers. In addition, the court determined that Hospira could not sustain its fraud and negligent misrepresentation claims based on AlphaGary’s statements to Moll with respect to the pellets: in the case of the fraud claim, Moll was not an agent or fiduciary of Hospira; and in the case of the negligent misrepresentation claim, there was no evidence that Hospira directly relied on the statements. Similarly, the court ruled that the statements could not support an unfair and deceptive trade practices claim because there was no evidence that the statements deceived Hospira or that Hospira actually relied on them.

The Court of Appeals reversed the Business Court’s dismissal of the negligence claim and ruled that, because Hospira and AlphaGary were not parties to a contract, Hospira’s negligence claim was not barred by the economic loss rule, which limits the ability of a plaintiff to recover on a tort claim when the plaintiff and the defendant are parties to a contract with respect to the matter on which the tort claim is based.

* * *

B. Guarantees
1. Transfer without assignment

Assignment of promissory note automatically transfers associated guarantee.

The North Carolina Court of Appeals considered whether the assignment of a promissory note automatically transfers an associated guaranty. Self-Help Ventures Fund v. Custom Finish, LLC, ___ N.C. App. ___, 682 S.E.2d 746 (2009). Basing its decision in part on analogous treatment of security interests and on persuasive authority from other states, the court concluded that, upon assignment of a note, the assignee has the right to enforce an associated guarantee even if the guaranty is not assigned specifically.

Self-Help Ventures Fund was a nonprofit corporation certified by the Small Business Administration (the “SBA”) to make loans under the SBA’s 504 loan program. Nonprofit corporations that are so certified are known as Certified Development Companies or CDCs. In 2002, Self-Help made an SBA loan to Custom Finish, LLC. The loan was evidenced by a promissory note and was guaranteed under separate guarantee agreements delivered by Clarence W. Adams, Gladys L. Adams and two other guarantors. No guarantor signed the promissory note in his or her individual capacity.
After making the loan, Self-Help assigned both the note and the guarantees to the SBA. Custom Finish defaulted on the loan in 2008, and the SBA assigned the note, but not the separate guarantees, back to Self-Help. After all of the guarantors defaulted on their guaranty obligations, Self-Help accelerated the loan and filed a lawsuit against Custom Finish and the guarantors seeking payment of principal and interest on the loan, as well as attorneys’ fees and court costs. The trial court granted summary judgment in favor of Self-Help, and the Adamses appealed.

In their appeal, the Adamses argued that Self-Help was not entitled to enforce their guarantees because the SBA did not assign the guarantees to Self-Help when it assigned the note. The Court of Appeals turned to the common law to evaluate the appeal, finding that the Uniform Commercial Code did not supply a resolution. Applying the common law, the court concluded that Self-Help could enforce the Adamses’ guarantees notwithstanding the fact that the SBA had not separately assigned them back to Self-Help.

In reaching its conclusion, the court noted that a guarantor’s liability depends on the terms of the guaranty and that, to determine the terms of the Adamses’ guarantees, it was appropriate to look not only at the guarantees themselves, but at the note as well. Under the note, the borrower promised “to pay to the order of the CDC” principal, interest, fees and other amounts required. The term CDC was defined in the note to include its successors and assigns. The note also provided that, upon default, the CDC could collect from a guarantor amounts due under the note. The Adamses’ guarantees unconditionally guaranteed payment of such amounts to “Lender” (which presumably was Self-Help initially) and, similar to the note, specified that the term Lender included its successors and assigns. The court observed that Self-Help was the CDC when the note initially was executed and was, by virtue of being an assignee, the CDC when the SBA assigned the note back to Self-Help. The court concluded that, therefore, the terms of the note and the guarantees unambiguously evidenced that the parties intended Self-Help to be entitled to enforce the Adamses’ guarantees.

Furthermore, the Court of Appeals determined that the failure of the SBA to specifically assign the guarantees to Self-Help was irrelevant; the mere assignment of the note was sufficient to give Self-Help the right to enforce the guarantees. In support of its conclusion, the court looked to the general rule stated in State v. Bank, 193 N.C. 524, 526, 137 S.E. 593, 594 (1927), that guarantees are assignable and enforceable by those entitled to enforce the obligation which it secures. The court also quoted language from Trust Co. v. Trust Co., 188 N.C. 766, 771, 125 S.E. 536, 538 (1924), stating that a guaranty is assignable and “goes with the principal obligation.” Moreover, the court observed that Idaho, Georgia and Ohio courts similarly had reached the conclusion that “a transfer of a promissory note also operates as an assignment of an associated guaranty . . . even without reference in the assignment of the note to the guaranty.” Finally, the court found no evidence that assignment of the Adamses’ guarantees conflicted with any of the principles under North Carolina law that would bar assignment. Specifically, the assignment to Self-Help would not “(1) violate a statute, public policy, or terms of the
guaranties; (2) materially alter [the Adamses’] risks, burdens or duties; or (3) violate personal confidence [the Adamses] placed in the obligee.”

Judge Wynn dissented from the majority’s decision. He focused on North Carolina precedent recognizing that, although related, a guaranty and a note are “nonetheless separate obligations.” According to Judge Wynn, because the Adamses’s guarantees were separate obligations, Self-Help had no right to enforce them absent their assignment by the SBA.

C. Security Agreements
1. Public sale of collateral

Terms of security agreement defining commercial reasonableness for public auction only apply if all terms specifically followed.

The North Carolina Court of Appeals considered the extent to which a public sale of collateral may be deemed commercially reasonable based on an agreement of the parties defining commercial reasonableness. Commercial Credit Group, Inc. v. Barber, ___ N.C. App. ___, 682 S.E.2d 760 (2009). The court concluded that the terms of a security agreement attempting to define when a public sale is commercially reasonable do not apply to any aspect of the sale unless the secured party complies with all of the terms.

In 2007, Commercial Credit Group, Inc. made a loan to Leland Barber, Jr. d/b/a B.M.E. Recycling to purchase a heavy duty waste recycler from Pioneer Machinery, LLC. Two warranties accompanied Barber’s purchase, and because the recycler stopped operating after only six hours of use, Barber soon needed warranty repairs. Despite assurances from Pioneer, the recycler was not repaired. Barber consequently defaulted on his loan, and Commercial Credit repossessed the recycler, which served as collateral.

The parties’ security agreement provided the following with respect to the collateral:

Any public sale will be deemed commercially reasonable if notice thereof shall be mailed to [Barber] at least 10 days before such sale and advertised in at least one newspaper of general circulation in the area of the sale at least twice prior to the date of the sale and if upon terms of 25% cash down with the balance payable in good funds within 24 hours[.]

On December 17, 2007, Commercial Credit mailed notice to Barber that Commercial Credit would hold a public auction of the recycler at Pioneer’s dealership in Glen Allen, Virginia (located near Richmond) on December 27, 2007. On December 23 and 26, 2007, Commercial Credit advertised the sale in the Richmond Times-Dispatch and The Daily Reflector of Greenville, North Carolina. The ads stated that the recycler would be
sold “as-is” and indicated that Commercial Credit had the sole discretion to require payment in full or more than 25% down at the time of the sale. Commercial Credit took no other action to seek out possible buyers.

Commercial Credit held the auction as planned on December 27, 2007, but only one other potential bidder was present and Commercial Credit placed the only bid. Being the only bidder, Commercial Credit purchased the recycler for $100,000, the amount of its bid. In January 2008, Commercial Credit sued Barber seeking a deficiency judgment with respect to the approximately $128,000 unpaid balance of the loan (after deducting the $100,000 purchase price of the recycler). In March 2008, Commercial Credit sold the recycler for $190,000 in a private sale. At the time of the sale, the recycler was in the same inoperable state that it had been in when Commercial Credit purchased it at the public auction.

In its opinion, the Court of Appeals cited N.C. Gen. Stat § 25-9-610(b)’s requirement that, for a sale to be commercially reasonable, “[e]very aspect of [the disposition], including the method, manner, time, place, and other terms, must be commercially reasonable.” After considering the time, manner and contents of the advertisements for the sale of, and the sale price for, Barber’s recycler, the court found that the public auction was not commercially reasonable.

Commercial Credit argued that the advertisements were commercially reasonable because they were deemed so by its security agreement with Barber. The Court of Appeals agreed that N.C. Gen. Stat. § 25-9-603(a) permits parties to agree on standards for commercial reasonableness, but concluded that the terms in the parties’ security agreement did not apply because Commercial Credit failed to comply with all of the terms. The agreement deemed a public sale of the recycler commercially reasonable if it were sold for “25% down with the balance payable in good funds within 24 hours,” and according to the court, the statements by Commercial Credit in the advertisements that it had the sole discretion to require payment in full or a larger percentage at the time of sale represented a “breach that was far from immaterial.” Looking solely to the statutory standard then, the court concluded that the advertisements were not commercially reasonable because they indicated that the recycler was to be sold “as-is” when warranties existed and because the advertisements were published only in newspapers of general circulation and so close to Christmas.

In addition to deficiencies in the content of the advertisements, the court found that the auction itself was not commercially reasonable because (i) the sale date, two days after Christmas, would almost certainly not have enhanced competitive bidding under N.C. Gen. Stat. § 25-9-610 for a “specialized and expensive” piece of inoperable equipment, (ii) Commercial Credit failed to exert sufficient effort to market the recycler to “legitimate prospective buyers” and (iii) the price paid for the recycler in Commercial Credit’s March 2008 private sale indicated that the $100,000 auction price was not reasonable.
After determining that the auction was not commercially reasonable, the Court of Appeals went on to deny Commercial Credit what it ultimately sought – a deficiency judgment for the unpaid loan balance. Under N.C. Gen. Stat. § 25-9-626(a)(3), if a secured party does not prove that it complied with the UCC requirements regarding disposition of collateral, a deficiency judgment is limited to the amounts due (including expenses and attorneys’ fees) minus the greater of (i) the actual disposition proceeds and (ii) the proceeds that would have been realized if the secured party had complied with the disposition requirements. Under N.C. Gen. Stat. § 25-9-626(a)(4), the amount that would have been realized is deemed to be the amounts due unless the secured party can prove otherwise. According to the court, Commercial Credit failed to prove that a commercially reasonable sale would have yielded less than the amounts due; therefore, it was not entitled to a deficiency judgment.
Questions

Question 1

Longleaf Pine Corp. is a NC corporation and bank holding company. In the wake of the financial crisis, Pine’s board approved a merger with Giant Redwood & Co. After execution of the merger agreement, but before any Pine shareholder vote, Pine and Redwood completed a share exchange under which Redwood received newly issued Pine preferred stock in exchange for Redwood common stock.

Did the Pine board breach its fiduciary duties by failing to obtain shareholder approval of the share exchange?

A. Yes. Shareholder approval of all share exchanges is required by statute, and failing to follow a statutory procedure is a breach of fiduciary duty.
B. Yes. Shareholder approval of a preferred for common share exchange is required by statute, and failing to follow a statutory procedure is a breach of fiduciary duty.
C. No. Shareholder approval only is required in a share exchange that compels the exchange of existing and outstanding shares.
D. No. Shareholder approval of all share exchanges is required by statute, but failing to follow a statutory procedure is not a breach of fiduciary duty.
Question 2

More about Longleaf Pine. When the Pine board approved the merger (including the share exchange), there were no other offers to acquire Pine, other than a markedly inferior one from Townigroup. The Pine stock issued in the share exchange represented almost 40% of Pine’s voting rights. Arenboat is a Pine shareholder who is upset about the proposed merger, but cannot prove that the board breached any fiduciary duty in approving it.

Can Arenboat secure a preliminary injunction against the share exchange?

A. Yes. It prevents the shareholders from taking advantage of another acquisition offer.
B. Yes. Redwood’s voting power makes approval of the merger a foregone conclusion.
C. No. The merger could be defeated because an absolute majority of votes is required for approval and there is no reasonable prospect of a superior proposal.
D. No. A plaintiff must prove breach of fiduciary duty to be successful in challenging a deal protection measure.

Question 3

Staying with Longleaf Pine. The shares issued to Redwood in the share exchange may not be redeemed by Pine for 18 months after the Pine shareholder vote on the merger.

Can Arenboat secure a preliminary injunction against the 18-month tail?

A. Yes. It would impede the Pine board’s duty to seek out other merger partners if the merger is defeated and enjoining will cause little harm to Pine or Redwood.
B. Yes. Deal protection measures may extend no more than six months after a shareholder vote.
C. No. Enjoining the 18-month tail would harm Pine and Redwood because it affects the structure of the merger.
D. No. A plaintiff must prove breach of fiduciary duty to be successful in challenging a deal protection measure.
**Question 4**

One last one about Longleaf Pine. The merger agreement includes a “limited fiduciary out” clause that requires Pine’s board to submit the Redwood merger to a shareholder vote even if a superior proposal materializes. In that case, the board’s only option is to submit the Redwood merger to the shareholders without recommendation, though it may explain why it is not recommending it.

Can Arenboat secure a preliminary injunction against the limited fiduciary out?

A. Yes. It impedes the Pine board’s duty to seek out other merger partners.
B. Yes. Submission of the Redwood merger agreement to a vote even without recommendation could be perceived as tacit approval.
C. No. The board could respond to a superior proposal, and withdrawing a recommendation, with explanation, would be advising against the merger.
D. No. A plaintiff must prove breach of fiduciary duty to be successful in challenging a deal protection measure.

**Question 5**

In July, Greg and Ken had the right to vote a majority of the common stock of Mirage, Inc., a NC corporation, and the Mirage board controlled the other shares. A shareholders’ meeting had not been held for some time, and Greg demanded one be held to remove and elect directors. Before the meeting, the board issued shares to two directors for less than fair market value. The new shares gave the board a majority of the voting rights. As a result, no directors were removed at the meeting and no board election was held.

If Greg and Ken assert direct claims against the directors for breach of fiduciary duty, will they survive a motion to dismiss?

A. Yes. Directors owe fiduciary duties both to the corporation and to individual shareholders.
B. Yes. Even though directors only owe fiduciary duties to the corporation, the facts support a claim for a statutory violation of a shareholder’s right to vote.
C. No. Directors owe fiduciary duties to the corporation, not to individual shareholders.
D. No. Issuance of the additional shares is subject to business judgment rule protection.
**Question 6**

Prilodata Inc. is a NC corporation. All seven shareholders initially were employees. Two shareholders, Paul and Joel, had reasonably expected employment, but were fired after a series of disagreements with the other shareholders threatened the corporation’s welfare. After firing Paul and Joel, the other shareholders increased their salaries, deferred a portion and exchanged deferred salaries for Prilodata stock, thereby reducing Paul’s and Joel’s ownership interests from 20.2% to 2.4%.

Will Paul and Joel be successful if they seek to have Prilodata judicially dissolved?

A. Yes. The other shareholders breached their fiduciary duties to Paul and Joel by diluting their ownership interests.
B. Yes. The other shareholders frustrated the reasonable expectations of Paul and Joel of continuing employment.
C. No. A corporation is not required to fulfill reasonable expectations of continuing employment if doing so threatens the well-being of the corporation.
D. No. The business judgment rule protects the decision to exchange deferred salaries for Prilodata stock.

**Question 7**

Mark guaranteed a loan by Bank to Hydro LLP. Bank also made a loan, secured by Blackacre, to PeeDee Inc., a NC corporation 99% owned by Mark. Hydro and PeeDee default. To avoid foreclosure of Blackacre, Mark says PeeDee will refinance. PeeDee conveys Blackacre to Mark’s wife’s company and uses the proceeds to pay part of the PeeDee loan. Mark defaults on a new note for the PeeDee loan balance, and Bank obtains judgments against Mark on the PeeDee note and the Hydro guarantee.

Bank wants a court to set aside the Blackacre conveyance and pierce PeeDee’s corporate veil to make Blackacre available to satisfy Mark’s guarantee obligations on the Hydro loan. Can the corporate veil be pierced in these circumstances?

A. Yes. “Reverse-piercing” is a valid substantive claim in North Carolina, and PeeDee was involved in the alleged wrong.
B. Yes. “Reverse-piercing” is a valid substantive claim in North Carolina, and PeeDee’s involvement in the alleged wrong is irrelevant.
C. No. North Carolina does not recognize “reverse-piercing” outside the context of personal jurisdiction.
**Question 8**

Hugh is a member-manager of Driveway LLC, a NC LLC. State filed a lawsuit against Driveway to recover civil penalties for statutory violations. State later amended its complaint to add Hugh as a party, seeking to hold him liable by “piercing the corporate veil.” The statute of limitations with respect to the civil penalties expired between the time State filed its original and amended complaints.

Is Hugh off the hook?

A. Yes. Hugh is a new party because North Carolina does not extend “piercing the corporate veil” to LLCs and relation back does not apply to new parties.
B. Yes. Hugh is a new party regardless of whether North Carolina extends “piercing the corporate veil” to LLCs and relation back does not apply to new parties.
C. No. Because Hugh is a manager of Driveway, he is not a new party and the amended complaint relates back to the date the original complaint was filed.
D. No. If the State can pierce Driveway’s veil, Hugh is not a new party and the amended complaint relates back to the date the original complaint was filed.

**Question 9**

Janet and three others were members of a NC LLC. Janet owned a 41.5% interest and was the LLC’s sole source of funding. The operating agreement provided that Janet would lend $500,000 to the LLC, but Janet loaned much more. The other members knew of the additional loans (but did not vote on them), and the company used them to pay liabilities. Janet sued after not being able to collect on the loans. The other members counterclaimed, alleging that Janet had breached fiduciary duties to them.

Did Janet owe fiduciary duties to the other members?

A. Yes. Members of a closely-held LLC always owe partner-like fiduciary duties to each other.
B. Yes. Although members do not owe fiduciary duties to each other under the NC LLC Act, Janet owed duties because she owned a controlling interest.
C. No. Members do not owe fiduciary duties to each other under any circumstance.
D. No. Members do not owe fiduciary duties to each other under the NC LLC Act, and Janet was not a controlling member because she owned only a 41.5% interest.
**Question 10**

Betty, Jack and Jim are members of a NC LLC. Betty wants to withdraw. The company’s articles of incorporation say nothing about withdrawal, and it has no operating agreement.

Can Betty withdraw voluntarily?

A. Yes. A member of an LLC can withdraw voluntarily at any time by express will.
B. Yes. A member of an LLC can withdraw voluntarily at any time upon 90 days’ prior written notice.
C. No. A member of an LLC can withdraw voluntarily only to the extent provided in the articles of organization or a written operating agreement.
D. No. A member of an LLC can withdraw voluntarily only to the extent provided in the articles of organization.

**Question 11**

Sluggish, Inc. obtained financing from Roma Bank to enable it to perform its pasta sauce contracts. As a condition, the Bank required Sluggish to engage Glenco, Ltd. to assist with the contracts. Accordingly, Sluggish entered into a contract with Glenco that included a forum selection clause requiring all disputes to be resolved by the courts in Rome. The Glenco contract was entered into outside North Carolina and was addressed to and approved by the Bank, but the Bank did not sign it.

Will a NC court applying North Carolina law allow the Bank to enforce the forum selection clause against Sluggish?

A. Yes. A forum selection clause is always enforceable if it is in a contract entered into outside North Carolina.
B. Most likely. A forum selection clause designating foreign jurisdiction in a contract entered into outside North Carolina is enforceable unless compelling reasons dictate otherwise.
C. No. A forum selection clause is not enforceable by a person that is not a party to the contract.
D. No. Roma forced Sluggish to enter into the Glenco contract.
Question 12

In 2003, BBQ, Inc. entered into a contract with Agneau Inc. under which BBQ was granted the right to use certain Agneau trademarks in connection with BBQ’s mutton barbecue and agreed to use “its commercially reasonable efforts” to make, market and sell its mutton barbecue under those marks. In 2009, Agneau filed a lawsuit against BBQ, claiming that BBQ has since 2007 failed to use “its commercially reasonable efforts” as required by the contract.

If North Carolina law applies, in order to have complied with the contract, BBQ must have used efforts from 2007 to 2009:

A. consistent with its past practices because “commercially reasonable efforts” is modified by the word “its.”
B. consistent with “industry” norms notwithstanding the fact that the term “commercially reasonable efforts” is modified by the word “its.”
C. consistent with its past practices and with “industry” norms because the term “commercially reasonable efforts” is modified by the word “its.”
D. consistent with “industry” norms for businesses of its size and circumstances because “commercially reasonable efforts” is modified by the word “its.”

Question 13

Inspira Corp. makes syringes using pelletized XYZ, a compound it developed. It entered into a contract manufacturing agreement with Toll, Inc. for some of its syringes. Rather than supplying pellets to Toll, Inspira directed Toll to Gamma LLC for pellets. Under a contract with Toll, Gamma supplied QRS pellets (not XYZ pellets) to Toll, which Toll used to manufacture the syringes. Gamma was aware of the Inspira/Toll agreement and had previously supplied Inspira with XYZ pellets.

If North Carolina law applies, can Inspira sue Gamma as a third-party beneficiary of the Toll/Gamma contract based on representations by Gamma to Toll regarding the pellets?

A. Yes. Inspira’s coordination of the Toll/Gamma contract alone makes Inspira a third party beneficiary.
B. Yes. Inspira’s coordination of the Toll/Gamma contract and Gamma’s awareness of the Inspira/Toll agreement make Inspira a third-party beneficiary.
C. No. Gamma did not make any direct false representation to Inspira regarding the pellets it supplied to Toll.
D. No. Inspira’s coordination of the Toll/Gamma contract and Gamma’s awareness of the Inspira/Toll agreement alone do not make Inspira a third-party beneficiary.
**Question 14**

Help Yourself Fund made an SBA loan to Standard Start, LLC. The loan was evidenced by a promissory note and was guaranteed by Jacob Eves and his wife Sarah in separate guarantee agreements. Help Yourself assigned the note and the guarantees to the SBA. When Standard Start defaulted on the loan, the SBA assigned the note, but not the guarantees, back to Help Yourself.

If North Carolina law applies, can Help Yourself enforce the guarantees against the Eveses?

A. Yes. The mere assignment of the note was sufficient to give Help Yourself the right to enforce the guarantees.

B. Yes. Not allowing Help Yourself to enforce the guarantees would violate public policy favoring transferability of contracts.

C. No. The note and the guarantees are separate obligations; therefore, Help Yourself is not entitled to enforce the guarantees unless specifically assigned.

D. No. Assignment would violate public policy because the Eveses always thought that the SBA would be entitled to enforce the guarantees.

**Question 15**

Credit Corp. made a loan to JPE Inc. secured by a backhoe. Under the security agreement, a public sale of collateral is commercially reasonable if advertised twice before the sale in a local newspaper of general circulation and the payment terms are 25% down, balance in 24 hours. JPE defaulted, and Credit held a public auction right after Christmas. It advertised as required, but the ads stated that Credit could require payment immediately. Credit placed the only bid at the auction and purchased the backhoe.

Do the terms of the security agreement govern whether Credit’s advertising efforts were commercially reasonable?

A. Yes. Credit complied with all of the requirements of the security agreement, and parties can agree on what is commercially reasonable.

B. Yes. Credit complied with the advertising requirements of the security agreement, and parties can agree on what is commercially reasonable.

C. No. Advertising that payment could be required immediately was a breach of the security agreement that was far from immaterial; the statutory standard applies.

D. No. Parties cannot agree on what is commercially reasonable; the statutory standard always applies.
### ANSWER KEY:

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>C</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>C</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>A</td>
<td>8</td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td>9</td>
</tr>
<tr>
<td>5</td>
<td>B</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>B</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>D</td>
<td>14</td>
</tr>
<tr>
<td>15</td>
<td>C</td>
<td></td>
</tr>
</tbody>
</table>