

itself in a lawsuit? *Mysels v. Barry*, 332 So.2d 38, Web 1976 Fla.App. Lexis 14344 (Court of Appeal of Florida)

**16.4 Debt Security** United Financial Corporation of California (United Financial) was incorporated in the state of Delaware. United Financial owned the majority of a California savings and loan association as well as three insurance agencies. The next year, the original investors in United Financial decided to capitalize on an increase in investor interest in savings and loans. The first public offering of United Federal stock was made. The stock was sold as a unit, with sixty thousand units being offered. Each unit consisted of two shares of United Financial stock and one \$100, 5 percent interest-bearing debenture bond. This initial offering was a success. It provided \$7.2 million to the corporation, of which \$6.2 million was distributed as a return of capital to the original investors. What is the difference between the stock offered for sale by United Financial and the debenture bonds? *Jones v. H.F. Ahmanson & Company*, 1 Cal. 3d 93, 460 P.2d 464, 81 Cal.Rptr. 592, Web 1969 Cal. Lexis 195 (Supreme Court of California)

**16.5 Special Shareholders' Meeting** Jack C. Schoenholtz was a shareholder and member of the board of directors of Rye Psychiatric Hospital Center, Inc. (Rye Hospital). Four years after the hospital was incorporated, a split had developed among the board of directors concerning the operation of the facility. Three directors stood on one side of the dispute, and three directors stood on the other side. In an attempt to break the deadlock, Schoenholtz, who owned over 10 percent of the corporation's voting stock, asked the corporation's secretary to call a special meeting of the shareholders. In response, the secretary sent a notice to the shareholders, stating that a special meeting of the shareholders would be held "for the purpose of electing directors." The meeting was held as scheduled. Some shareholders brought suit, claiming that the special shareholders' meeting was not called properly. Who wins? *Rye Psychiatric Hospital Center, Inc. v. Schoenholtz*, 101 A.D.2d 309, 476 N.Y.S.2d 339, Web 1984 N.Y.App. Div. Lexis 17818 (Supreme Court of New York)

**16.6 Dividends** Gay's Super Markets, Inc. (Super Markets), was a corporation formed under the laws of the state of Maine. Hannaford Bros. Company held 51 percent of the corporation's common stock. Lawrence F. Gay and his brother Carrol were both minority shareholders in Super Markets. Lawrence Gay was also the manager of the corporation's store at Machias, Maine. One day, he was dismissed from his job. At the meeting of Super Markets's board of directors, a decision was made not to declare a stock dividend for the prior year. The directors cited expected losses from increased

competition and the expense of opening a new store as reasons for not paying a dividend. Lawrence Gay claims that the reason for not paying a dividend was to force him to sell his shares in Super Markets. Lawrence sued to force the corporation to declare a dividend. Who wins? *Gay v. Gay's Super Markets, Inc.*, 343 A.2d 577, Web 1975 Me. Lexis 391 (Supreme Judicial Court of Maine)

**16.7 Duty of Loyalty** Edward Hellenbrand ran a comedy club known as the Comedy Cottage in Rosemont, Illinois. The business was incorporated, with Hellenbrand and his wife as the corporation's sole shareholders. The corporation leased the premises in which the club was located. Hellenbrand hired Jay Berk as general manager of the club. Two years later, Berk was made vice president of the corporation and given 10 percent of its stock. Hellenbrand experienced health problems and moved to Nevada, leaving Berk to manage the daily affairs of the business. Four years later, the ownership of the building where the Comedy Cottage was located changed hands. Shortly thereafter, the club's lease on the premises expired. Hellenbrand instructed Berk to negotiate a new lease. Berk arranged a month-to-month lease but had the lease agreement drawn up in his name instead of that of the corporation. When Hellenbrand learned of Berk's move, he fired him. Berk continued to lease the building in his own name and opened his own club, the Comedy Company, Inc., there. Hellenbrand sued Berk for an injunction to prevent Berk from leasing the building. Who wins? *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355, 495 N.E.2d 1006, Web 1986 Ill.App. Lexis 2486 (Appellate Court of Illinois)

**16.8 Shareholder Resolution** The Medical Committee for Human Rights (Committee), a nonprofit corporation organized to advance concerns for human life, received a gift of shares of Dow Chemical (Dow) stock. Dow manufactured napalm, a chemical defoliant that was used during the Vietnam Conflict. Committee objected to the sale of napalm by Dow primarily because of its concerns for human life. Committee owned sufficient shares for a long enough time to propose a shareholders' resolution, as long as it met the other requirements to propose such a resolution. Committee proposed that the following resolution be included in the proxy materials circulated by management for the annual shareholders' meeting:

*RESOLVED, that the shareholders of the Dow Chemical company request that the Board of Directors, in accordance with the law, consider the advisability of adopting a resolution setting forth an amendment to the composite certificate of incorporation of the Dow Chemical Company that the company shall not make napalm.*

Dow's management refused to include the requested resolution in its proxy materials. Committee sued, alleging that its resolution met the requirements to be included in the proxy materials. Who wins? *Medical*

*Committee for Human Rights v. Securities and Exchange Commission*, 139 U.S. App. D.C. 226, 432 F.2d 659, Web 1970 U.S. App. Lexis 8284 (United States Court of Appeals for the District of Columbia Circuit)



## Ethics Cases

**16.9 Ethics** Lawrence Gaffney was the president and general manager of Ideal Tape Company (Ideal). Ideal, which was a subsidiary of Chelsea Industries, Inc. (Chelsea), was engaged in the business of manufacturing pressure-sensitive tape. Gaffney recruited three other Ideal executives to join him in starting a tape manufacturing business. The four men remained at Ideal for the two years it took them to plan the new enterprise. During this time, they used their positions at Ideal to travel around the country to gather business ideas, recruit potential customers, and purchase equipment for their business. At no time did they reveal to Chelsea their intention to open a competing business. The new business was incorporated as Action Manufacturing Company (Action). When executives at Chelsea discovered the existence of the new venture, Gaffney and the others resigned from Chelsea. Chelsea sued Gaffney and the others to recover damages. *Chelsea Industries, Inc. v. Gaffney*, 389 Mass. 1, 449 N.E.2d 320, Web 1983 Mass. Lexis 1413 (Supreme Judicial Court of Massachusetts)

1. What is the fiduciary duty of loyalty?
2. Did Gaffney act ethically in this case?
3. Did Gaffney and his partners breach their fiduciary duty of loyalty?

**16.10 Ethics** M.R. Watters was the majority shareholder of several closely held corporations, including Wildhorn Ranch, Inc. (Wildhorn). All these businesses were run out of Watters's home in Rocky Ford, Colorado. Wildhorn operated a resort called the Wildhorn Ranch Resort in Teller County, Colorado. Although Watters claimed that the ranch was owned by the corporation, the deed for the property listed Watters as the owner. Watters paid little attention to corporate formalities, holding corporate meetings at his house, never taking minutes of those meetings, and paying the debts of one corporation with the assets of another. During a vacation visit, two guests of Wildhorn Ranch Resort drowned while operating a paddleboat at the ranch. The family of the deceased guests sued Watters to recover from Watters. *Geringer v. Wildhorn Ranch, Inc.*, 706 F.Supp. 1442, Web 1988 U.S. Dist. Lexis 15701 (United States District Court for the District of Colorado)

1. What does the doctrine of piercing the corporate veil provide?
2. Did Watters act ethically in denying liability on the contract?
3. Is Watters personally liable in this case?



## Internet Exercises

1. Select a name you would like to use as a corporate name. Go to the website of the U.S. Patent and Trademark Office, at [www.uspto.gov](http://www.uspto.gov). Click on "Trademarks" and then "Search Marks" and check to see if the name you have chosen has been trademarked.
2. Visit the website of Network Solutions, at [www.networksolutions.com](http://www.networksolutions.com). Pick out a name that you would like to get as a domain name. Check the availability of that domain name.
3. Go to [www.harley-davidson.com/en\\_US/media/downloads/Foundation/Articles\\_of\\_Incorporation.pdf](http://www.harley-davidson.com/en_US/media/downloads/Foundation/Articles_of_Incorporation.pdf) to view the articles of incorporation of Harley-Davidson, Inc.
4. Go to [http://investor.harley-davidson.com/CorporateGovernance.cfm?locale=en\\_US&bmLocale=en\\_US](http://investor.harley-davidson.com/CorporateGovernance.cfm?locale=en_US&bmLocale=en_US) to view the bylaws of Harley-Davidson, Inc.
5. Go to the website of the Delaware Division of Corporations, at <http://corp.delaware.gov/faqs.shtml>. Read about incorporating a corporation on Delaware.

## Endnotes

1. Public Law 107-204 (2002).
2. 26 U.S.C. Section 6242 et seq.

**United Nations Children's Fund (UNICEF)**

An agency of the United Nations whose primary function is to provide aid to improve the lives of the world's children.

**European Union (EU)**

A regional international organization that comprises many countries of Western and Eastern Europe and was created to promote peace and security as well as economic, social, and cultural development.

**WEB EXERCISE**

Go to [http://europa.eu/about-eu/countries/index\\_en.htm](http://europa.eu/about-eu/countries/index_en.htm) and review the map of the European Union. What are the current candidate countries for membership in the EU?

**euro**

A single monetary unit that has been adopted by many countries of the EU that comprise the *eurozone*.

**North American Free Trade Agreement (NAFTA)**

A treaty that has removed or reduced tariffs, duties, quotas, and other trade barriers between the United States, Canada, and Mexico.

One of the most important international regional organizations is the European Union (EU), formerly called the *European Community*, or *Common Market*. The EU, which was created in 1957, is composed of many countries of Western and Eastern Europe. Member nations are Austria, Belgium, Bulgaria, Cyprus (the Greek part), Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom of Great Britain and Northern Ireland. The EU represents more than 500 million people and a gross community product that exceeds that of the United States, Canada, and Mexico combined.

**EU Administration**

The EU's Council of Ministers is composed of representatives from each member country who meet periodically to coordinate efforts to fulfill the objectives of the treaty. The council votes on significant issues and changes to the treaty. Some matters require unanimity, whereas others require only a majority vote. The member nations have surrendered substantial sovereignty to the EU. The European Union Commission, which is independent of its member nations, is charged to act in the best interests of the union. The member nations have delegated substantial powers to the commission, including authority to enact legislation and to take enforcement actions to ensure member compliance with the treaty.

The EU treaty creates open borders for trade by providing for the free flow of capital, labor, goods, and services among member nations. Under the EU, customs duties have been eliminated among member nations. Common customs tariffs have been established for EU trade with the rest of the world.

**Euro**

A single monetary unit, the euro, has been introduced. Many, but not all, EU countries have voted to use the euro. The countries that have voted to use the euro comprise the *eurozone*. The euro can be used in all countries of the *eurozone*. An EU central bank, equivalent to the U.S. Federal Reserve Board, has been established to set common monetary policy.

A unanimous vote of existing EU members is needed to admit a new member. Other nonmember European countries are expected to apply for and be admitted as members of the EU.

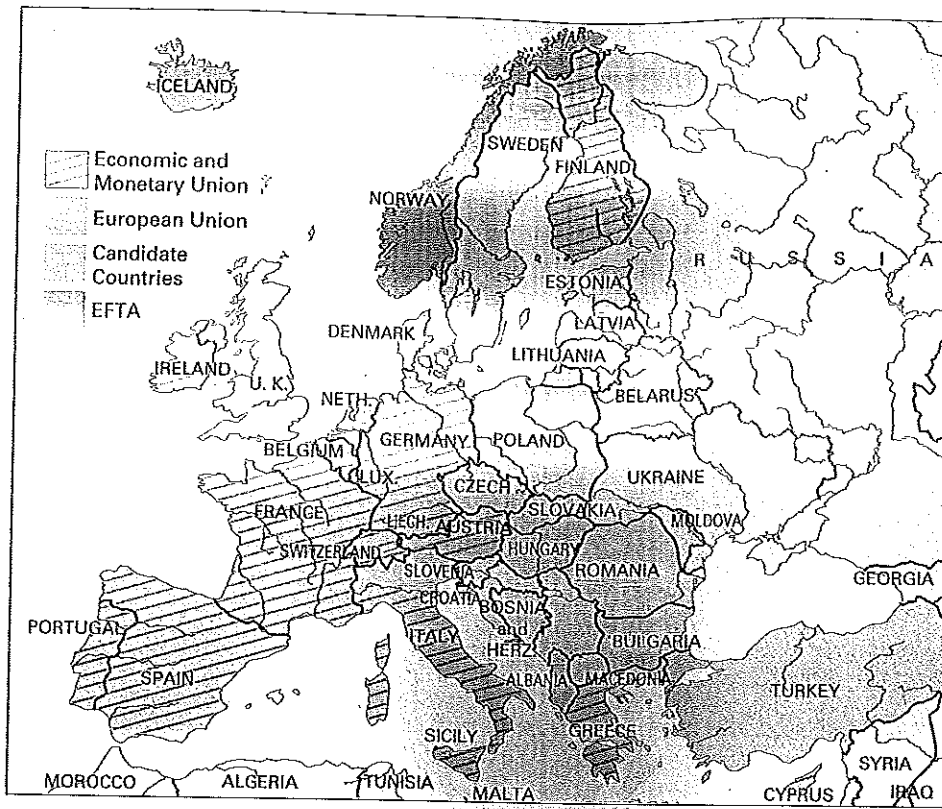
A map of EU member countries is shown in Exhibit 26.1.

**North American Free Trade Agreement (NAFTA)**

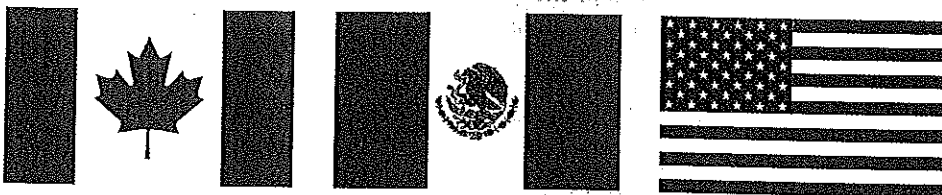
In 1990, Mexico asked the United States to set up a two-country trade pact. Negotiations between the two countries began. Canada joined the negotiations, and on August 12, 1992, the North American Free Trade Agreement (NAFTA) was signed by the leaders of the three countries. The treaty creates a free trade zone stretching from the Yukon to the Yucatan, bringing together more than 400 million people in the three countries.

NAFTA has eliminated or reduced most of the duties, tariffs, quotas, and other trade barriers between Mexico, the United States, and Canada. Agriculture, automobiles, computers, electronics, energy and petrochemicals, financial services, insurance, telecommunications, and many other industries are affected. The treaty contains a safety valve: A country can reimpose tariffs if

**Exhibit 26.1 MAP OF THE EUROPEAN UNION (EU) MEMBER COUNTRIES**



an import surge from one of the other nations hurts its economy or workers. Like other regional trading agreements, NAFTA allows the bloc to discriminate against outsiders and to cut deals among its members. NAFTA also includes special protection for favored industries that have a lot of lobby muscle. Thus, many economists assert that NAFTA is not a "free trade" pact but a *managed trade* agreement.



NAFTA forms a supernational trading region that more effectively competes with Japan and the EU. Consumers in all three countries began to pay lower prices on a wide variety of goods and services as trade barriers fell and competition increased. Critics contend that NAFTA shifted U.S. jobs—particularly blue-collar jobs—south of the border, where Mexican wage rates are about one-tenth those in the United States. Environmentalists criticize the pact for not doing enough to prevent and clean up pollution in Mexico.

A map of NAFTA member countries is shown in Exhibit 26.2.

**WEB EXERCISE**

Go to [www.worldtradelaw.net/nafta/preamble.pdf](http://www.worldtradelaw.net/nafta/preamble.pdf) and read the Preamble to the North American Free Trade Agreement (NAFTA).

into a free trade agreement with all the countries of Central America, as well as Chile, Colombia, and Venezuela. Other regional economic organizations include countries of Central America and South America. Several regional economic communities have been formed in Africa as well.

## WORLD TRADE ORGANIZATION



(5)

## World Trade Organization (WTO)

In 1995, the World Trade Organization (WTO) was created as a successor to the General Agreement on Tariffs and Trade (GATT).

The WTO is an international organization whose headquarters is located in Geneva, Switzerland. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible. WTO members have entered into many trade agreements among themselves, covering goods, provision of services, and intellectual property.

Through rounds of negotiations among its membership, the WTO aims to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules. The Doha Round is the latest round of trade negotiations among the WTO membership. The Round is also known semi-officially as the Doha Development Agenda as a fundamental objective is to improve the trading prospects of developing countries.

The WTO has jurisdiction to enforce the most important and comprehensive trade agreements in the world among its 153 member nations and custom territories. Many believe the WTO is a much-needed world court that can peaceably solve trade disputes among nations.

### World Trade Organization (WTO)

An international organization of 153 member nations created to promote and enforce trade agreements among member countries and customs territories.

### General Agreement on Tariffs and Trade (GATT)

A multilateral treaty that establishes trade agreements and limits tariffs and trade restrictions among its member nations.

*My nationalism is intense internationalism. I am sick of the strife between nations or religions.*

Mahatma Gandhi

### WTO panel

A body of three WTO judges that hears trade disputes between member nations and issues panel reports.

### WTO dispute settlement body

A board composed of one representative from each WTO member nation that reviews panel reports.

### WTO appellate body

A panel of seven judges selected from WTO member nations that hears and decides appeals from decisions of the dispute-settlement body.

## WTO Dispute Resolution

One of the primary functions of the WTO is to hear and decide trade disputes between member nations.

A member nation which believes that another member nation has breached one of the trade agreements can initiate a proceeding to have the WTO hear and decide the dispute. The dispute is first heard by a three-member WTO panel, which issues a panel report. The members of the panel are professional judges from member nations. The report, which is the decision of the panel, contains the panel's findings of fact and law, and it orders a remedy if a violation has been found. The report is then referred to the WTO dispute settlement body. This body is required to adopt the panel report unless the body, by consensus, agrees not to adopt it.

There is a WTO appellate body to which a party can appeal a decision of the dispute-settlement body. This appeals court is composed of seven professional justices selected from member nations. Appeals are limited to issues of law, not fact.

If a violation of a trade agreement is found, the panel report and appellate decision can order the offending nation to cease engaging in the violating practice and to pay damages to the other party. If the offending nation refuses to abide by the order, the WTO can order retaliatory trade sanctions (e.g., tariffs) by other member nations against the noncomplying nation.

## National Courts and International Dispute Resolution

The majority of cases involving international law disputes are heard by national courts of individual nations. This is primarily the case for commercial disputes between private litigants that do not qualify to be heard by international

### national courts

The courts of individual nations.