

Instructions

This examination consists of 3 essay questions. Your answers to each question will be weighted equally when determining your grade. You have **three (3) hours** in which to complete the exam. The recommended time for each question is one (1) hour. Please budget your time so you can adequately answer each question.

Before starting to write, you should read each question carefully and spend some time organizing your answer. Your goal should be to identify the issues, recite applicable law and then apply and analyze the facts. Strive for precision and brevity and avoid getting stuck on one issue or topic.

Good Luck.

Empire College School of Law
Professor Rutherford
Business Organizations – Final
Spring Semester
April 9, 2012

Student ID _____

Question 1

Pete, David and Mark each owned 100 shares of the issued and outstanding stock of Classic Guitars, Inc., a California corporation (“Classic”) and were Classic’s only shareholders. They served as the corporation’s three directors.

A couple of weeks ago, Eric, the President of Giant Guitar Company (“Giant”) called Pete and told him that Giant wanted to acquire Classic. Eric said that Giant would pay top dollar for Classic’s stock. Pete knew that Giant had a poor reputation in the music industry after acquiring and then mercilessly looting a number of small companies. Pete said that he would consider Giant’s offer.

The next day, Pete called David, who was traveling out of state, and offered to purchase David’s stock in Classic. David asked Pete if anyone else had expressed any interest in buying Classic. Pete said, “No.” “In that case,” said David, “I’ll sell my shares to you.”

A few days after buying David’s stock, Pete called Eric and agreed to sell all 200 of his Classic shares to Giant. The price per share Giant paid Pete was more than 4 times the amount Pete had paid David.

At the next shareholders’ meeting, Giant elected two of its corporate officers to Classic’s Board of Directors as replacements for Pete and David. The Giant-controlled Board then voted to pay out all of Classic’s retained earnings to Giant and Mark as dividends, forcing Classic to borrow money at a high interest rate to continue operations. The Board also agreed to sell Classic’s inventory of custom guitars to subsidiaries of Giant at a fraction of their value. Mark’s shares of Classic stock soon became worthless.

What rights and remedies, if any, do David and Mark have against Pete and Giant?

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Question 2

In 2011, Papa's Big Game Fishing, Inc., a Delaware corporation ("Fishing") lost millions of dollars in a failed attempt to open fishing resorts in the Caribbean. Fishing employees had bribed local officials to secure development rights and fishing permits. The venture collapsed when an investigative reporter discovered the payments and published an expose in the Wall Street Journal.

A group of shareholders filed a derivative action against Fishing's directors. The plaintiffs allege that they are excused from making a demand on Fishing before pursuing their lawsuit because a majority of the directors approved the illegal payments. Fishing appointed a litigation committee to evaluate the lawsuit. The committee consisted of directors who were not members of the Board when the payments were made. After discussing the matter with Fishing's accountants and lawyers, the committee concluded that the lawsuit should be dismissed.

Jim is a director of Fishing who voted in favor of paying the bribes. He was indicted on criminal charges and pled no contest to one minor charge in return for dismissal of the more serious ones. Jim asks that you advise him about the chances of the shareholders' suit going forward, and if it does, of the likelihood that he will be found liable. He points out that Fishing's Articles of Incorporation provide that the liability of directors to the corporation and its shareholders is eliminated to the fullest extent allowed by law. He is running out of money and hopes that Fishing will cover his attorneys' fees and any losses he suffers in this lawsuit and will reimburse him for the defense costs associated with the criminal proceeding.

Please advise him.

Question 3

Innovative Automobiles, Inc. (“Innovative”) is a Delaware corporation with over 20,000 shareholders and more than \$100,000,000 in assets. Innovative’s stock trades on the NYSE. Innovative is developing a solar-powered car that its directors feel will revolutionize the auto industry.

Betty, the President of Fast Motors, Inc. (“Fast”), recently called Joan, the President of Innovative. Betty told Joan that Fast plans to acquire Innovative. At a meeting convened the next day, an investment banking firm told the Innovative directors that Fast most likely was pursuing Innovative to gain control of the solar car project. Feeling that Fast’s actions threatened Innovative’s business plan, the Innovative directors decided to sell a large block of Innovative’s common stock to Lucky Motors (“Lucky”). The Innovative directors trusted Lucky to assist them in combating Fast’s actions.

Selling stock to Lucky required that Innovative amend its Articles of Incorporation to increase the number of authorized shares. Innovative sent a proxy solicitation to its shareholders asking them to approve the amendment. The proxy solicitation explained that the sale of stock to Lucky was part of the board’s plan to resist Fast’s takeover bid. The proxy solicitation also falsely accused Betty of being a convicted felon. The shareholders approved the amendment.

Fast then announced a tender offer for Innovative shares. In response, the Innovative board agreed to sell Innovative’s solar car division to Lucky if Fast acquired more than 20% of Innovative’s stock. The sale agreement did not include a “fiduciary out”. After learning of Innovative’s deal with Lucky, Fast cancelled its tender offer. The price of Innovative’s stock plummeted.

Please evaluate whether or not the Innovative directors have any potential liability to Innovative, its shareholders, or to Fast as a result of these actions. Innovative’s Articles of Incorporation provide that the liability of directors to the corporation and its shareholders is eliminated to the fullest extent allowed by law.