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Empire College School of Law
Business Organizations
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FINAL EXAM
3 Hours

This examination covers Introduction to Forms of Business Entities through Insider Trading and Other Securities Fraud (Chapters 1-19).

This examination will test your knowledge of the materials that we covered in class. Please answer each question concisely. Please use headings, underline issues and rules, as this will help you organize your thoughts, spot and frame the legal issues, and present the rules and doctrines clearly. Try to answer all questions with complete sentences. Do not use abbreviations, other than those commonly used for each business organization (like LLP). Answer all questions presented. If you cannot answer a question completely, answer as best you can. If not all fact are present, by all means, address scenarios. Partial answers will be given partial credit. Please write clearly. **Good luck!**

Answer (Brief Outline):

All Business Forms: Pros- Cons

Attorney – Believes he can fairly represent both; Full disclosure to both Clients & signed consent

Risk adverse/prudent business attorney: err on conservative side.

Client might not think is now competing, but too much risk for

exposure to liability (e.g., employment agreement, non-competition agreement, non-compete clause, HR, patent infringement, and family/close relationship of married couple, possible future or existing conflict of interest, honesty, full disclosure, etc.)

Or, assume another client in office: Fire Wall & memo from that attorney

Directors Duties – Duty of Loyalty; Duty of Care

Duty do officers and directors owe the corp if they are involved in a transaction with the corp? -- A director or officer has a duty of loyalty to act in good faith and with the conscientiousness, fairness, morality, and honesty that the law requires of fiduciaries.

Shareholder Duties – Majority to minority Shareholders, not enough on facts

PART I (50 POINTS)
100 Mins.

Nancy Smith and Linda Cohen are colleagues at Radient, a large Santa Rosa company headquartered in Silicon Valley. Linda, an engineer, also serves the Board of a small DNA testing lab. Nancy is in marketing and travels nationwide and abroad on behalf of Radient. They both own stocks in Radient, which is traded on the New York stock exchange ("RAD"). Long-time friends from the Empire Running Club, Linda and Nancy make it a point to have lunch together when Nancy is in town. At their most recent lunch at *Yum* in Railroad Square, Linda confided in Nancy that she is growing increasingly frustrated with her boss who she feels is not open to her innovative ideas even though Linda has a proven track record in creating new products and testing schemes. Linda is getting tired of what she calls the "corporate Rat Race" and she would like to start her own company. She thinks she has come up with a new idea for some products and testing protocols that Radient to date is not offering. Nancy, on the other hand, is a bit weary from all her travelling. In her late 30s, she would like to settle down and start a family, and travel less. Nancy is worried, however, about not having enough money to start a business. On the other hand, she also

has a lot of belief in her friend Linda. Nancy does have a rich uncle, Willie Moore, however, who is willing to invest in a new business venture. Willie, more interested in golfing, does not want to be involved with day to day operations, but would like some return on his investment, if possible.

Bob Cohen is married to Linda. He also serves on the Board of Directors of Radiant, and he too owns stock in Radiant. When he heard of his wife's lunch meeting, he offered to meet with both Nancy and Linda. He has also asked that you, a lawyer for Radiant, be there, and that you prepare a memo advising them on the new business idea.

Please discuss (1) whether it be advisable for you to be at the meeting, and if not, why not and what other ideas you would suggest; (2) whether it be advisable to have Bob involved with the new business venture and, if so why, or why not; (3) which business forms exist as alternatives for Nancy and Linda, and what the pros and cons of each of them are; (4) what duty, if any, Nancy and Linda owe as employees and shareholders of Radiant, and what duties, if any, Bob owes as a director and shareholder.

PART III (20 POINTS)

Answer the following questions.

1. Please discuss the various levels of indemnification officer and directors enjoy from a corporation, including when officer/director indemnification is mandatory, permissive, or prohibited. Please include discuss what limitation or elimination of liability may properly be included in Articles, and which kinds of acts may not be thus limited or eliminated.

The level of indemnification officer and directors can enjoy from the corp include: They can seek reimbursement from the corp if they are sued in their capacity as an officer or director and incur costs such as attorney fees, fines, a judgment, or settlement. Officer/director indemnification (reimbursement of legal fees) is prohibited if officer or director was held liable to the corp or held to have received an improper personal benefit. Officer/director indemnification mandatory if they were successful in defending the action. The rule for permissive indemnification of officers/directors (use this rule if mandatory/prohibited indemnification don't apply) is:

(1) A corp may reimburse if the officer/director acted in good faith and reasonably believed the act to be in corp's best interest.

(2) The ct can order the Corp to reimburse litigation expenses and attorney fees if the corp is reasonably entitled to the fees, but reimbursement can't include judgment against the officer/director.

Types of that acts cannot be indemnified by the corp through inclusion of a provision in its Articles are: Articles can provide for limitation or elimination of liability for damages, but not for breach of duty of loyalty, intentional misconduct, or wrongful personal benefit.

2. When seeking minority shareholder approval for a proposed cash-out merger, which test must a corporation comply, and what do those two prongs entail:

Fair dealing – which impose a duty on the corporations to completely disclose to the shareholders all information germane to the merger; and

Fair price – which requires that the price being offered for the outstanding stock be equivalent to a price determined by an appraisal where “all relevant non-speculative factors” were considered. Weinberger.

3. Define the term *limited liability*.

The term limited liability refers to limitations placed on business owners' personal responsibility for the debts and obligations of their businesses. If a business organization provides owners limited liability, creditors cannot look to the business owners' personal assets to satisfy business debts and obligations.

4. List as many factors you can that are considered in deciding whether to “pierce the corporate veil.”

- Absence or inaccuracy of corporate records;
- Concealment or misrepresentation of members;
- Failure to maintain arm's length relationships with related entities;

- Failure to observe corporate formalities in terms of behavior and documentation;
- Failure to pay dividends;
- Intermingling of assets of the corporation and of the shareholder;
- Manipulation of assets or liabilities to concentrate the assets or liabilities;
- Non-functioning corporate officers and/or directors;
- Significant undercapitalization of the business entity (capitalization requirements vary based on industry, location, and specific company circumstances);
- Siphoning of corporate funds by the dominant shareholder(s);
- Treatment by an individual of the assets of corporation as his/her own;
- Was the corporation being used as a *façade* for dominant shareholder(s) personal dealings; *alter ego* theory.

(not all of these factors need to be met in order for the court to pierce the corporate veil. Further, some courts might find that one factor is so compelling in a particular case that it will find the shareholders personally liable.)

5. What is the difference between a limited partnership and a limited liability partnership?

A limited partnership is managed by general partners, who are personally liable for all debts and obligations of the partnership. Limited partners are merely investors in a limited partnership's business and do not have the right to participate in management of the business. In contrast, limited liability partnerships (LLPs) offer all partners management rights and limit partners' vicarious liability for the negligence and malfeasance of their partners.

6. List the 6 elements of a securities fraud action, and which Act that applies.

- (1) Material misrepresentation (or omission)
- (2) Scienter (wrongful state of mind)
- (3) Connection with the purchase or sale of a security
- (4) Reliance (often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation") – nonconclusively presuming that the price of a publicly traded share reflects a material misrepresentation & that the P have relied upon the misrepresentation as long as they would not have bought the shares in its absence);
- (5) Economic Loss; and
- (6) Loss Causation (i.e. casual connection between the material misrepresentation & the loss").

The (federal) Securities Exchange Act (of 1934)

7. Explain the difference between a sole proprietorship and a partnership.

A sole proprietorship is a business conducted by one person. A partnership is conducted by two or more persons or entities.

8. What is a POISON PILL?

One of the common mechanisms used to defend against a hostile takeover. It is a plan by which shareholders in the target corporation are given the right to be bought out by the corporation at a substantial premium on the occurrence of a stated triggering event.

9. What is the "Misappropriations Theory"?

One who misappropriates nonpublic information in breach of a fiduciary duty & trades on information to his own advantage violates Sec 10(b) of SEC & Rule 10b-5. Securities & Exchange Commission/SEC v. *Materia* p. 970 (US Ct of Appeals, 2d Circuit Found (1) printer's fiduciary duty to his employer (Firm specializing in & its clients to maintain their confidences; & (2) that *Materia* had actual knowledge of his duty & thus acted w Scienter (bc Bowne has a Policy explicitly forbidding employees from trading on info in course of work; Written Statements of prohibition were clearly posted in Bowne's plant, & copies distributed to all employees). "PRINTER#2"/*Materia*

10. What is a Tender Offer?

An offer made by one corporation to the shareholder of a target corporation to purchase their shares subject to number, time, and price specifications.

END OF EXAMINATION