

Empire College of Law

Spring Semester 2017

Business Organizations

Final Examination

Issue Outlines

Professor: Rob Rutherford

## Question 1

1. **Should the court dismiss the derivative action because the plaintiff lacked standing for failing to make a demand on the Spy board before commencing the lawsuit?**
  - a. Delaware law applies under the Internal Affairs Doctrine.
  - b. Is a derivative action appropriate or should the action be brought as a direct on behalf of the shareholders?
    - i. Rule: Depends on who was damaged—the corporation or the shareholders—and which of the two should receive any damages that may be awarded.
      1. Spy was injured by the unfair deal.
      2. Opportunity belonging to Spy was diverted to Listening.
  - c. **Statutory rules of Civil Procedure generally require that a shareholder first make demand on the board before initiating a derivative action unless making such a demand would be futile.**
  - d. **The plaintiff in a demand futility case must plead with particularity facts raising a reasonable doubt that:**
    - i. The directors were interested in the transaction and therefore not entitled to the protection of the business judgment rule; or
    - ii. That the action by the directors was not the product of a valid business judgment.
  - e. Analysis:
    - i. Majority of board interested directors: doubt entitled to bjr.
    - ii. Allegation that L directors withheld information from S about how the deal was priced raises doubt that the L directors are entitled to protection of the BJR and instead suggests that they were not disinterested.
2. **Did Listening and the five (5) common directors breach their fiduciary duty to Spy and its shareholders?**
  - a. Rule: The fiduciary duty of a parent corporation to a subsidiary requires that the parent not gain a benefit at expense of the subsidiary.
    - i. Listening paid too little—unfair price
    - ii. Unfair process
    - iii. The sale transaction is not intrinsically fair
3. **Did review and approval by an independent committee pull the transaction back within the protection of the BJR?**
  - a. **An independent committee of the subsidiary evaluating the deal must function free of influence by the parent. Deal will fall under business judgment rule if committee acted independently.**
    - i. Gus improperly in the discussion.

- b. Rule: All facts must be disclosed by the parent for independent director approval to secure BJR approval for directors.
  - i. Gus and Listening never disclosed lowball price
  - ii. The committee lacked independence and was not fully informed of how the deal was priced
- 4. **The complaint should not be dismissed as it pleads adequate grounds for demand futility. Listening and the five directors that controls face liability for breach of fiduciary duty of loyalty.**

## Question 2

### 1. Did Linda breach her fiduciary duty to Dolly?

- a. Shareholders of a closely held corporation know each other a fiduciary duty.
- b. That fiduciary duty requires that shareholders treat each other fairly and not defeat each other's reasonable expectations regarding their ownership interests in the Corporation.
- c. Linda excluded Dolly from a future upturn in the market.
- d. Linda withheld information that was material to Dolly's decision and profited at Dolly's expense.

### 2. Issue: did Linda violate SEC rule 10 B – 5 by using insider information she learned from Best without disclosing it to Dolly?

- a. 10b-5 prohibits any false or misleading statement, or failure to make disclosure when necessary to make the statements not misleading, in connection with the purchase and sale of the security.
- b. Jurisdiction: applies to all corporations regardless of size. Even Tucson would be covered with only to shareholders
- c. misrepresentation that a reasonable investor would find changes the total mix of information
- d. reliance
- e. scienter
- f. sale or trade of securities
- g. loss causation
- h. Linda withheld material information from Dolly. Dolly, as a shareholder in a closely held corporation with Linda, could rely on the expectation that Linda would deal fairly with her. Dolly sold stock as a result of Linda's failure to disclose. Linda's omission caused Dolly to sell her stock below its value. Linda is liable to Dolly for the damages she incurred

### 3. Issue: Is Linda criminally liable for violating the rule 10b-5?

- a. Justice Department has authority to prosecute violations of the rule.
- b. Linda traded insecurities of Best based on inside information.
- c. Linda's actions demonstrate scienter to violate rule 10b-5

### 4. Issue: is Linda liable to Best for any profit she made trading on inside information?

- a. For an action to lie under 10 B5 the plaintiff must have traded or sold the securities. Best and the remaining shareholders fail to meet that standing requirement.
- b. State Law is split on whether breach of fiduciary duty of directors by trading on inside information provides the basis for the Corporation to recover from the director.

### 5. Issue: is Dolly liable is a tippee for following Linda's directions to sell her Best stock?

- a. A tippee inherits liability from the tip for the tip first disclose the information in violation of the fiduciary duty and for the benefit of the tipper.
- b. Linda, as a director of Best, disclosed the bad news in violation of her fiduciary duty.

- c. Limited to disclosed the information for her own benefit – because she wanted to ease her conscience.
  - d. The circumstances should have made clear to Dolly that Linda was improperly using insider information when she passed the tip along to Dolly. Dolly therefore had the necessary scienter.
- 6. Issue: is Linda liable to the Corporation for violating the short swing trading restrictions of section 16b.**
- a. 16 B applies only to reporting corporations that meet the jurisdictional requirements. The number of shareholders and the total number of assets of B meet those jurisdictional requirements
  - b. 16 B is a strict liability statute that forces certain corporate insiders to disgorge any profits made through the purchase and sale or sale and purchase of securities in transactions within six months of each other. Mr. is a
  - c. Damages are computed to maximize the amount recovered and eliminate any possibility of profit by the insider.
  - d. Insiders consist of 10% shareholders, directors, and officers.
  - e. Linda is liable under 16 B as she has trades within six months of each other and she needs jurisdictional requirement of being a director
  - f. the 100 shares Linda sold for \$120 each on October 1 would be paired with 100 of the 200 shares she bought at \$50 each on November 1. The difference is \$70 per share multiplied by 100. Linda owes Best Corporation \$7000

### Question 3

- 1) **Issue: Did the directors of Friends breach their fiduciary duty of loyalty to the corporation and its shareholders?**
- 2) **Duty of Loyalty imposes unique obligations on directors in a hostile takeover situation.**
- 3) **Rule: the actions of directors and standing on a hostile bid are evaluated by the standards of Unocal**
  - a) **Directors must establish that their defensive actions were in good faith and in response to a reasonably perceived threat**
  - b) **The business judgment rule requires that directors adequately inform themselves.**
  - c) **The actions of a disinterested board are given the benefit of the doubt**
- 4) **Analysis: The board was not comprised of disinterested directors, being split 6 to 6 between inside and outside directors.**
  - a) The directors were told that the offer was fair and that the bidder enjoyed a good reputation.
  - b) Directors reached own decision – and an informed one – not to recommend the deal.
- 5) **Rule: Response must be proportionate to perceived threat**
  - a) Self-tender might be a reasonable response but was risking damaged credit standing might be going too far.
- 6) **Issue: did false statements violate the Williams act and constitute an excessive response violating the Unocal duties?**
  - a) The Williams act prohibits any false statement in connection with the tender offer.
  - b) Friends does not fall within the jurisdictional limits of the Williams act.
  - c) False statements were a coercive response to the tender offer.
  - d) Placing friends in a precarious financial state was also excessive.
- 7) **Because of its excessive response to the tender offer, the board of friends violated its fiduciary duty of loyalty.**
- 8) **Issue: Does Big have standing to sue under the Williams Act?**
  - a) No: participants in the tender offer have no standing to sue each other
  - b) no jurisdiction
  - c) may be state law causes of action for interference with business relationships.
- 9) **Issue: Did the directors of friends violate their duty under the Revlon test?**
  - a) **Revlon requires directors to become auctioneers and maximize value when a change in control or breakup of the company becomes inevitable**
  - b) Directors made the breakup inevitable by the option for the LA restaurants.
  - c) The directors ended the bidding process by locking up the deal
- 10) **Issue: What remedies to the shareholders of Friends have?**
  - a) invalidate the option as a breach of the directors fiduciary duty
  - b) recover damages.