1.| 90
2.| 75
3| 80

81.67

1)

A derivative action can be brought by a shareholder, on behalf of a corporation, asserting that the corporation has been harmed by a director or officer's actions. Here, the shareholder is asserting a breach of fiduciary duty. A derivative action differs from a direct action which an action where a shareholder asserts that they were personally harmed, separate and apart from harm to the corporation.

Generally, in a derivative action, a shareholder is required to first seek redress from the corporation itself before bringing a legal action. When a shareholder fails to do so, it must analyzed whether they are excused from that requirement. The requirement will be excused if the shareholder can establish demand futility. Pursuant to the *Arronson* case, to satisfy demand futility, the shareholder must establish, with particularity, a reasonable doubt that the deciding directors were disinterested/independent or that the decision was outside the realm of the business judgment rule. Essentially that going to the corporation first would have been pointless.

Rule →

Great

The shareholder could possibly plead with particularity that the decision was not made by disinterested or independent directors. Although the four directors who were part of the committee were disinterested themselves, there appears to be a lack of independence. Gus was heavily involved in the process given that the committee regularly consulted with him and he was present at all the meetings. However, general assertions about a directors allegiance are not particular enough to satisfy demand futility. Courts have routinely failed to find demand futility when there are merely generalized allegations that directors were not disinterested or independent. However, the most important fact is that Gus was tasked with drafting reports about potential sales and he withheld the information about the low balled price and the narrow scope of the CFO's analysis. Gus was heavily involved and played a significant role in the commitee's decision making process. His withholding of the information regarding the CFO's analysis is more than a generalized allegation. It is a particular fact that raises a reaonable doubt as to his independence. Given his influential role with the commitee, that fact is particular enough to establish a reasonable doubt regarding the committees independence thus establishing demand futility.

Excellent Analysis!

Right!

Also, there is certainly some merit to the claim of a breach of fiduciary duty. One specified circumstance where a breach occurs is where a party is involved on both sides of the transaction and also if they have a pecuniary interest. Here, that applies to Gus. He is on the board of both Spy and Listening. Although the four disinterested directors were elected to evaluate the offer, the facts state that they regularly consulted with Gus. Gus did not act in the financial best interest of Spy thereby breaching his fiduciary duty.

The L Directors failure to disclose how the price was determined supports this.

Furthermore, as part of the breach of fiduciary duty is an analysis regarding usurping which is established by the corporate opportunity doctrine. Here, Gus learned of the Spy Cracker technology as part of his position on Spy's board. He then went and informed Listening about the technology which prompted Listening to seek an exclusive right to sell it. The Spy Cracker was in the line of Spy's business given that Spy is a surveillance equipment company. Nothing in the facts indicates that Spy was not in a financial position to sell the Safe Cracker technology. Gus's disclosure to Listening about information he obtained through his position at Spy was detrimental to Spy shareholders. However, usurping might not apply here because this isn't a situation where information was learned from an outside party and Gus failed to inform Spy about it and instead used the information in an advantageous way for himself. Rather, the information was obtained from Spy's research department so clearly Spy had adequate opportunity to act on the information. But as previously mentioned, Gus most certainly breached his fiduciary duty to Spy. It is clear he was working in the best interest of Listening, to the detriment to Spy's shareholders.

Nice - a good analogy even if not a perfect fit

The other directors of Spy also likely breached their fiduciary duty. Knowing that Gus was on the board of Listening, yet allowing him to be heavily involved in the committee decision process was unreasoably. Furthermore, failing to conduct their own financial analysis and relying heavily on the report from Listening's CFO was not acting in good faith. They failed to ensure they were adequately informed and harmed their shareholders with the Safe Cracker deal with Listening.

There is also a potential violation of the Williams Act by Listening. Listening's CFO made hasty calculations as to how much should be paid for the Safe Cracker technology. The CFO ignored a critical factor when making the calculations and as a result, the price was low. This information was then presented to Spy as part of Listening's offer. Under the Williams Act, a corporation may be liable when it makes misrepresentations in a tender offer. Particularly important, is that the misrepresentation was material in persuading Spy to sell Safe Cracker. The facts are unclear about whether Listening's board were aware of the CFO's miscalculations. If they were, and the misrepresentation was done intentionally, then Listening violated the Williams act. Mere negligence however, is typically not enough.

No offer for stock, so Williams doesn't apply

Great job

2)

Did Linda violate the law with her conduct?

SEC rule 16b is designed to prevent short swing trading in large publicly traded companies such as Best. WIth $15 million in assets it exceeds the $10 million requirement for 16b. A 10% shareholder, director or officer who buys and sells stock within 6 months is in violation of this rule and the profits from these sales must be returned to the corporation. Because Linda is a board member of Best she falls under 16 B. Under 16b she would be liable to best for any profits she obtained by short swing trading. For maximum punitive and deterrent effect under 16b the highest sale price is matched with the lowest purchase price during the 6 month time frame. Linda bought at $50 a share on Nov 1 and sold at $120 a share on Oct 1 so her profit that she must disgorge to Best is ($12,000-$5,000=$7,000). A constructive trust would be imposed on Linda's profits to disgorge her unjust enrichment.

Linda also violated 10b 5. 10 B 5 prohibits fraud or failure to disclose material facts in connection with the sale of securities. 10 B 5 has been determined by the court to protect against insider trading. Linda has violated this rule by her conduct. Linda is a fiduciary of Best as a member of the board. She learned of a Material fact because the existence of this article would cause a reasonable investor to sell stock in best because it reflects badly on the product they are selling. In order to be liable under 10 b 5 their must be scienter or a intention to deceive. Linda was well aware this article would change the value of the Best stock and sought to take advantage of the markets lack of this material knowledge. A fiduciary must disclose a material fact if they choose to trade stock they don't have to disclose if they abstain from trading in stock but that is not the case here. Linda would be criminally liable under 10 B 5. Also Linda would be liable to any Best Shareholder that traded in best stock during the time that the material fact was not disclosed. Linda would also be liable to Dolly under 10 B 5 for her purchase of Dolly's shares in Tucson. Here again Linda was aware of a material fact that would have affected Dolly's decision to sell her shares. Linda acted with the intention to capitalize on her insider knowledge in order to profit off Dolly's shares in Tucson. Linda may also be liable to Dolly because Tucson appears to be a close corporation and in California share holders in a close corporation have been found to have a fiduciary duty towards fellow shareholders similar to a partnership. Here Linda mislead Dolly and bought the shares in bad faith without disclosing a material fact of the value of the company.

Is Dolly LIable for selling her Best stock on Linda's advice?

In this situation Linda is an insider and Dolly is a tippee. A tippee can be liable under 10 B 5 for acting on the tip of an insider if the tippee is aware of the fiduciary relationship held by the insider to the company. Here Dolly and Linda were business partners and Dolly told her about the Journal article which only a best insider could know about. The Insider must also receive a benefit or intend to make a financial gift of the information for the tippee to be liable. Here Linda is seeking to alleviate her guilt so she receives that benefit and makes a gift of the information to Dolly. Dolly will be liable under 10 B 5 for insider trading under Tippee Liability.

Great job
I appreciate the strong organization

2)

profit of $7,000 which will be disgorged.

3)

Liability to Shareholders -
In most cases, the Business Judgment Rule will protect the business decisions the of officers and directors of a corporation so long as they act in good faith. However, in the case of a tender offer, buyout or merger, the business judgment rule does not apply. This is because the directors cannot be disinterested when their jobs and control of the company are on the line. This is especially true where six of the directors are executive employees of the company as well as directors. They are not disinterested. Therefore, the test becomes one of intrinsic fairness and whether, when all relevant factors are consider the transaction was fair. Here, the directors were able to act only because they breached their duty to their shareholders and omitted pertinent information from the letter they sent out, that the CFO warned the transaction would seriously affect the financial viability of the company.

In this case, friends has reason to be worried about the shareholders filing a derivative action against them. Big made a tender offer to the shareholders and Friends' directors responded in a way that dramatically dropped the value of he share price.

Good statement of the Rule

Under the UNOCAL test, a board may take defensive action in the case of a hostile takeover if they have a good faith belief in the threat and the defensive action taken was reasonable in relation to that threat. Furthermore, the action cannot be made simply in an effort to maintain control of the corporation. Here, the directors claim they are concerned that Big gaining the controlling stock will result in the failure of their restaurants as they don't know how to run a sushi restaurant and that dividends will suffer. It could be argued that the running of the restaurant is not a real threat, as Big has run restaurant franchises throughout the United States and Europe, and is clearly experienced in running restaurants, even if not specifically Asian restaurants. Their business plan was praised by the industry analysis. It seems more likely that the directors, especially the executive employees, were concerned about their jobs. However, even if there was a legitimate concern, Friends runs into a problem with the second element of the Unocal Test, whether the action was reasonable in the face of the threat.

While the suffering of dividends may be a concern, not only did Friends buyout of the outstanding stock drained all of their surplus capital and hurt the corporations credit standing. This almost certainly hurt the dividends as much or more than another board

running the corporation could. Furthermore, they brought in the white knight of Fancy Foods to further drop the value of the stock, making Friend's even more undesirable. It appears by dropping the value of their corporation and making the tender offer to their shareholders, they put their corporation in serious financial insecurity. All so that they could protect themselves from buyout. This was completely out of proportion with the alleged threat and certainly did not protect them in any way.

Furthermore, the shareholders could argue that under Revlon that the directors had an obligation to maximize the benefit to the shareholders in the face of the tender offer. However, Revlon only applies in cases where the sale is inevitable or there is some triggering event, such as a change in power. This does not appear to be the case here as Friend's is not struggling, and while they offered to sell some restaurants to Fancy Foods, this is probably not enough to be considered a triggering event. There is nothing to indicate that the sale of Friends was inevitable in this case. The directors will not be liable under Revlon.

But the Optional did end the bidding

Good discussion

Here Friends' breach their duty to their share holders and will be liable as a result.

The Williams Act of the 1934 SEC ACT governs tender offers:

Rule 14a of the 1934 SEC Act regulates tender offers and prohibits misleading information in proxy solicitations. This rule also covers the omission on information that would make the information actually disclosed, not misleading. In determining whether the misstatement or omission is material, the courts look to whether a reasonable shareholder would want to know the information in deicing on how to vote, or whether it will effect the "total mix."

Here, the directors sent a letter to their shareholders with a serious omission, that by taking action, they would lose their surplus capital and hurt their credit rating. They also assured the shareholders of their financial solvency when they knew that in recommending the redemption offer, they would be in serious financial trouble. Financial viability would be material to any shareholder making a decisions. Had the shareholders known that by accepting the redemption offer and rejecting Big's tender offer the value of their existing stock would drop dramatically, they almost certainly would not have taken the option.

The directors could argue that the omission was simply the opinion of the CFO and therefore there was no misrepresentation. However, the omission of an opinion can be material if it relates to a material fact. Here, the CFO of the company had a very material opinion as to what would occur if the board went through with its plan and failed to mention that to the shareholders. It is likely the CFO's opinion was based on facts that could be demonstrated in the evidence. This was a material omission.

However, for a corporation to be liable under the Williams act, they must meet the federal registration jurisdictional requirements. Thin includes that the company is (1) publicly traded, (2) has at least 500 shareholders, and (3) more than $10 million in assets. Friend's claims only $8 million in assets and therefore does not meet the requirements. There will be no action under Rule 14a.

Liability to Big

While Big may feel they have been harmed due to Friends' actions against the tender offer, an unsuccessful tendorer has no standing to sue under the Williams act, even if the jurisdictional requirement was met, and no fiduciary duty as covered by the Unocal Test. Big cannot sue Friends.

END OF EXAM

Nice Work