

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!**

## PART I (60 POINTS)

**A.** In June 2010, Nancy Smith and her SSU friend Linda Cohen approached you about an idea to manufacture sporty laptop computer bags, which they would like to call Sono-bags. Nancy's rich uncle Bob will invest \$100,000. Bob also has Petaluma offices space that the college grads are allowed to use for free (following the dot-com bust, local commercial leasing space was at 20% vacancy rates). Bob is also a lawyer and has offered to be their lawyer. Nancy and Linda come to you (a friend from the local 20-30 Club) for advice. Draft a memo on which business forms to consider, the pros and cons of each, and whether it is advisable for Bob to be their lawyer, and if not, why not.

**B.** By May 2014, benefiting from the young founders' hard work, and some remarkable growth in the personal computer industry, Sono-bags (by then a publicly traded Petaluma-based corporation), has stock valued at \$50/share. Things have changed a bit since 2011: Bob now wants to get paid for the office space (vacancy rates are down), Linda had a baby in 2012 and has worked less and less; leaving Nancy with an ever-increasing workload. Nancy is tired of working relentless hours. During a walk around Spring Lake, Nancy decides she wants to get out of their company, to fulfill her lifelong dream to scale Mount Everest.

Squirrel, a publicly-traded Sportswear corporation headquartered in Santa Rosa, enters into an agreement with Nancy (now both a majority shareholder and a director) of Sono-bags. The agreement states that, as long as no Sono-bags directors lost their seats on the board of directors, Nancy would sell her 60% interest to Squirrel for \$100 per share, giving Squirrel control of Sono-bags. The sale is likely to make the other 40% of Sono-Bags stock less valuable because Squirrel has over the years borrowed heavily and paid its shareholders large dividends.

On a long-overdue Girls Weekend (touring Sonoma wineries), Nancy got a bit tipsy and told fellow director Linda, in confidence, of her plans to sell her shares. Nancy told Linda that she was going to sell small quantities of shares over a period of several months, in order to try to not alert the public or other shareholders of the fact that she is selling all of her stocks. On Monday, Linda (thinking her stock might go down once Squirrel takes over) sold all her shares for the \$50 market price.

Shortly thereafter, Nancy entered the agreement with Squirrel. Nancy was interviewed by the *Press Democrat*, and when asked about the future of Sono-bags, said she was optimistic about Sono-bags' future, and would buy more stocks. She did not disclose that she was, in fact, selling all of her Sono-bags stock. The stock price of Sono-bags went up as a result of the *PD* article. Plaintiff Peter, after reading the article, bought 100 shares of Sono-bags at \$60/shares.

Four months later, Squirrel issued a press release announcing that it owned the majority of Sono-bags. Three days later, Sono-bags stock fell to \$20/share. Also, earlier that week, Squirrel announced that a production facility in Forestville had spilled chemicals (used to treat neoprene) into Russian River.

Peter Plaintiff lost \$40/share in the value of the stock. Discuss whether any laws were broken in the above scenario and, if so, what remedies Plaintiff and other Sono-bags shareholders might be able to pursue.

PART II (40 POINTS)

Answer the following questions.

1. What are the three venues under which Securities Fraud actions may be brought?
2. Describe the different tools used to shield directors and officers from personal liability for actions (or inactions).
3. What are the statutory requirements for forming a *de jure* corporation?
4. Describe the Williams Act and the policy reasons behind its enactment.
5. What are the three most common shareholder agreements?
6. Describe the Business Judgment Rule, as well as factors to be considered in “piercing the corporate veil.”
7. What are some anti-takeover strategies, and how do they work?
8. What is the “Misappropriations Theory”?
9. Who is a Promoter, what does he/she do, and what is the extent of a promoter’s liability?
10. What must Articles of Incorporation include?

END OF EXAMINATION