1.80

1)

The Proxy Statement.

The Williams act prohibits false and misleading information in a proxy statement. There are jurisdictional requirements that a corporation have 500 shareholders or more, and assets of 10M. Both Power and Rocket meet the jurisdictional requirements. If it is shown that information is ommitted, or intentionally misleading, or even negligently included in a proxy statement, the shareholders may be able to have the merger rescinded or recover damages. The proxy statement that was sent to Power's shareholders included a misleading statement about it being difficult to find anothe rpurchser for Power's fuel other than Rockets. If the shareholders investigate the company records and find that this was not the real reason the Power directors recommended the merger they may have grounds for an action for breach of the duty of Care and Loyalty. Further, the shareholders have already discovered the omission regarding the team's study and this omission would be deemed to be material, that is a fact that would is important enough to influence a decision on whether or not to vote in favor of the proxy.

Were the terms fair to the Power shareholders?

A merger is a negotiated change of control and a fundamental corporate change. When two companies merge, there is a surviving corporation and a disappearing corporation. There were five irectors who were on both sides of this transaction which creates an inherent conflict and possible breach of the duty of loyalty.

Duty of Loyalty and the Duty of Care.

The standard for the duty of care is what a reasonable person in like position would do in similar circumstances. A director has a duty to fulfill his role with good faith and in a reasonably informed manner. The business judgment rule is a rebuttable presumption that the director does just that, and pulls a cloak of protection over the decisions that are made by a board of directors.

Directors owe the corporation and its shareholders a duty of loyalty. When the interests of directors are in conflict with the interest of the corporation and the shareholders, and the interests of the director is put ahead of the corporation there is a breach. There are three main ways this happens: interested director transactions, usurpation of a corporate opportunity and competing with the corporation. The problem here is that there are interested directors who are on both sides of this potential merger.

If the Power directors had put the merger proposal to a vote of disinterested directors, or disinterested shareholders, and they voted to accept the merger the deal would have fallen under the safe harbor statutes of Delaware and their decision would be protected by the business judgment rule. However, there is no evidence from the facts that this was done, so they will need to prove the intrinsic fairness of the deal. To prove intrinsic fairness the Power directors will need to show that there was a fair dealing and a fair price.

The process that was undertaken by Power started off well. Appointing an independent committee to evaluate the proposal and hiring an investment banker shows that they were investigating the merger proposal and fulfilling their duty of good faith. But Brenda the banker was also on the committee and she had a business relationship with Rocket having done deals with them. She clearly wasn't disinterested as she appears to not be looking at the information in front of her if it was against the deal. So, it can be argued by the Power shareholders that this was not a fair process, the deal is not protected by the business judgment rule, and a breach of the duty of loyalty will likely be found.

Even if they find that the process was fair, they will then have to look at whether or not the price was fair. Here, there is no evidence on price but even without evidence it is clear that there is an argument that Power did not negotiate a fair price because they did not know how much money Rockets could save as a result of the merger. Rockets will argue that Power's expert concluded that the terms were fair, but that conclusion came without full disclosure by Rockets, or their directors who were also directors of Power. If the court finds that the process and teh price are not fair then the directors of Power will have breached their fiduciary duty to the shareholders.

The directors will be liable for damages as a result of the merger, and may be able to have it enjoined or rescinded.

Entrenchment.

For the disappearing corporation, there is heightened scrutiny regarding possible director entrenchment. This would be a breach of the duty of loyalty because it is putting the interest of the director in front of the best interest of the corporation. Some of Power's directors may end up without a position and accompanying benefits after the merger is approved. However, because Power appointed an independent committee, the danger of entrenchment is not likely.

Majoirty Shareholders duties to minority shareholders.

Good

A majority shareholder with control owes a fiduciary duty to the minority shareholders that they will act with good faith and fair dealing. Here, Rocket takes full advantage of its majoirty position to coerce Power into a deal that isn't in the best interest of the corporation. Rockets even threatened the President of Power that they wouldn't purchase from them anymore without a successful merger. This is a breach of the duty of good faith and fair dealing, and the Power shareholders may have an action against Rocket for this as well for damages.

2)

A derivative suit is a lawsuit that can be brought by shareholders of a corporation (corp) against an officer or director for harm caused to the corp. The requirements for derivative suit are that the shareholders must have standing and they must make a demand on the corp to bring the suit. It appears the shareholders have standing as

nothing in the fact pattern suggest otherwise, but it does not appear they made a demand on the corp first.

However, this requirement can be excused if the shareholders can show demand futility. Under Arronson, To show demand futility, the shareholders must establish, with particularity, the directors are not disinterested or the decision would fall outside of the business judgement rule (BJR). Merely asserting the directors are not disinterested is insufficient.

Here it appears that the shareholders can meet this burden, as all of the directors seemed to be involved and all of them are subjected to the lawsuit. As such, the shareholders should be able to establish with particularity why going to the board first would have been essentially pointless. The suit will be able to proceed.

Duty of Care.

THe directors owe Pure a duty of care, that is they must acted as like a reasonable prudent person would in managing the corp.

In managing the corp they are protected by the BJR, which creates a strong presumption that they act in the best interest of the company.

To rebut this presumption, the plaintiff must show that the directors either were grossly negligent (Van Gorchom (VG)) by failing to properly inform themselves and do their due diligence or they breached the duty of loyalty.

After the VG case many states, including Delaware, passed legislation, allowing companies to include in the articles exculpation clauses that limit the directors' liability for breach of the duty of care. However, acting in bad faith, acting illegally or breaching the duty of loyalty will not be protected acts under any exculpation clause.

Here, Pure has an exculpation clause that eliminates liability to the fullest extent of the law. As such, even if the shareholders can show the directors acted grossly negligent by falling to properly inform themselves about the repercussions that would come from ignoring the EPAs letter they would likely be unable to recover due to this clause. Thus, the shareholders will be required to show the directors acted in bad

faith in managing the company and they should have a strong case to back this assertion up.

The shareholders can argue that all the directors acted in bad faith by completely failing to act on the EPA letter. Simply ignoring a government letter that has the power to shut the company down passes the line of grossly negligent and enters into bad faith. It is common knowledge that the EPA has shut down multiple companies in the past for destruction of the environment and that they take environment protection very seriously. By doing absolutely nothing when they received the letter was in complete bad faith. This point is further reinforced by the fact that Pure employs an environmental consultant that expressly warned them repeatedly that the company was impacting the local watersheds.

These warnings coupled with the letter from the EPA put the board on notice that they needed to act and failing to take any actions can only be labeled as bad faith. Additionally, the boards actions could be considered illegal. Depending on the type of damage that was done to the environment and the type of disregard can be shown the board acted with criminal charges could be issued. It should be noted that criminal charges in situations like this is very rare.

Nice Counter Arguments

The board will counter that failing to act on one letter is insufficient to constitute bad faith. Government agencies send these types of letters all the time and it can hardly be argued that it was bad faith for failing to act after only one warning letter. Furthermore, the cost to rectify the situation would likely be too high and immediately acting would harm Pure too much financially. The BJR and the exculpation clauses existed for scenarios just like this. The board made a business decisions not to immediately act on the EPA letter believing it was in the best interest of the corp.

Furthermore, the other board directors can claim they were relying on Susan's advice that the letter was no big deal. While relying only on this advice is questionable under a gross negligent theory, it certainly enough to not be considered bad faith.

This would be a close call. It seems likely that the other directors reliance on Susan's advice would be enough to eliminate any bad faith argument that the shareholders could make. For Susan, it is a much more difficult decision and it seems likely that

her complete disregard for the letter and her further assurances, without any knowledge on the situation to the board would be considered bad faith.

If it is determined that any of the board members acted in bad faith or criminally, the shareholders would be able to recover. However if it is just mere negligence, the exculpation clause should protect the directors from liability.

Indemnification.

Under Delaware law, a corporation has a mandatory duty to indemnify any director that is successful in defending the case on the merits. That is there was no judgement issued against them.

Additionally, a corp can include a permissive identification clause that allows the corp to pay fees as long as the directors did not act in bad faith and they did not knowingly violated the law.

Thus, whether the directors will have their litigation expenses covered will depend on the outcome of the case. As discussed above, there is a possibility that the directors can be found to have acted in bad faith. If this is the case then Pure cannot reimburse them for any of their fees. However, if it is found that they did not act in bad faith then the indemnity clause should cover all expense incurred from the derivative action.

3)

Kathy (K)

K will be liable criminally and civilly for her actions as discussed below.

10b5

10b5 provides that it is unlawful for any individual, either directly or indirectly, through any instrumentally of interstate commerce or the mail, to employ a fraudulent or

deceptive device in connection with the sale of stocks. Subsequently, courts have held that 10b5 also prohibits insider trading.

TO be found in violation 10b5 it must be shown that the information used was material and the individual acted with scienter. Additionally, for a private plaintiff to recover civilly, it must be shown their reliance on the information was the cause of the damages.

Information is material if there is a substantial likelihood that a reasonable investor would find the information important. Scienter is the intent to mislead defraud or use the information for personal gain.

Here it is unclear what hat K was wearing when she obtained the inside information, but if she obtained the information in her role as an officer she will be liable. However, if she obtained the information as as a girlfriend she might be able to avoid liability for a violation of rule 10b5, but this seems unlikely.

IF the inside information was obtained as her role as the senior vice president she will most likely be found in violation of 10b5 for insider trading. Acting as a fiduciary of the corp she obtain inside information that a big star would sign with the company and the Hollywood's stocks would soar. This information was material as clearly a reasonable investor would find this information highly important in deciding whether to invest in the company. The prospect of a popular actor such as Daredevil that has the type of market appeal that can vastly influence the value of the company, evidet but the 100% stock increase just by rumors of his signing, is a very material fact.

Additionally, K acted with scienter as she as she had the intent and did use the information in an attempt to make a financial gain. K made the purchase the very next day after learning about the information and she used all of her money in her bank account. All this information points to her intent to use the information for personal gains. As such she acted with scienter. K can attempt to argue that this was not inside information, as there were rumors swirling around the industry that he was going to sign. However, they were just that. Rumors. She had knowledge from the actor's lawyer that he would be signing with the company.

Thus she would be liable both civilly and criminally for violation of 10b5. It should be noted that the DOJ is responsible for prosecuting individuals for insider trading.

It is highly unlikely that K is not found liable for a violation of 10b5, however, If she obtained the information as Charles' girlfriend she might be able to avoid liability.

Charles is a lawyer for a firm that represents actors that is completely separate from Hollywood. As such he merely gave his girlfriend information related to his work. However this argument is likely to fail. It can be asserted that regardless that Charles is not representing Hollywood he still has a confidential relationship with the corp. As such, he can not use or tell individuals about inside information obtained through this confidential relationship. This falls under the misappropriation theory of 10b5. Additionally, K \knew about the confidential relationship and still traded on the inside information. While it is highly unlikely that it will be found that K did not receive the information as an officer, K will be liable under either theory.

She obtained the information as an officer of the company. And since she acted with scienter on material inside information she will be held liable criminally and civilly for 10b5 violation.

It should be noted that Charles will avoid liability under a tipper theory if K gained this information as an officer as he was merely talking about a deal with the officer of the company rather than giving his girlfriend insider information for a personal benefit.

Short swing trades

In addition to the 10b5 violation K also appears to have violated rule 16b.

Rule 16b prevents short swing trades of stocks in large publicly traded companies with over 500 shareholders and 10 million in assets. Here the facts indicate that Hollywood has 10,000 shareholders and more than 20 million in assets. Thus, there is jurisdiction under rule 16.

Any director, officer or 10% or more shareholder of one of these companies that buys and sells stocks within a 6 month period is in violation of Rule 16b and will be required to pay all profits back to the company. For maximum punitive and deterrent

effect the highest sale price will be matched with the lowest purchase price when determining the amount.

Here, K is the senior vice president of Hollywood and has bought and sold stocks within a 6 month period. Thus she is in violation of rule 16b. K can argue that she did not know about this rule but this will fail as, unlike a 10b5 violation, a person is strictly liable for a rule 16b violation regardless of intent.

Thus, to determine damages, the court will match the highest sale price (10,000 shares at $20) with the lowest purchase price (10,000 shares at $5.) This totals the $150,000 dollars the bankruptcy court is asking for back. As such she will be liable that amount.

END OF EXAM