

Professor Matthews Exam. Number \_\_\_\_\_

Fall 1994

## CORPORATIONS FINAL EXAMINATION

### Instructions:

1. You have 3 hours and 15 minutes to complete this exam. Your answers will be collected in the room in which the exam is handed out at 11:45 a.m. Late bluebooks will be penalized.
2. All answers must be written in bluebooks. Please write on only one side of a page, but you do not need to double space. Please number your answers to correspond to the question and sub-part you are answering, but you need not answer in any particular order. Please number your bluebooks also.
3. This final is closed book. You are NOT permitted to use any casebook, statutory supplement, or any other materials. Any review materials in your possession should be placed at the front of the room before the exam begins.
4. Assume that Arkansas law applies to the transaction, and that any corporation is governed by the Arkansas Business Corporation Act of 1987 unless otherwise indicated.
5. Please turn in the copy of the test along with your answers, and label both with your exam identification number.
6. If any ambiguity or typographical error appears in any question, state the ambiguity, make your assumption, and proceed accordingly. I am sorry not to be with you personally today to resolve any such issue, but I will be sending good thoughts.
7. This exam consists of the following parts, divided into subparts as indicated. Please budget your time carefully. You should apportion it approximately as follows:

### Question Points Time

I 33 60 min.

II 33 60 min.

III 17 30 min.

IV (Short 17 30 min. Answer)

TOTAL 100 180 min.

### Question I.

(33 Points, 60 Minutes)

Alpha Corporation has 10,100 shareholders, divided into 100 class A common shares which are privately held, and 10,000 class B common shares held by more than five hundred persons which are publicly traded over the counter. It has over \$5 million in assets. One of its shareholders, Armstrong, has come to see you about a transaction that was recently approved by the shareholders.

On October 15, 1994 the nine-member board of Alpha Corporation met to consider the sale of 90% of its assets to the Omega Corporation. The board voted 6-3 to approve the sale in `return` for 100,000 common shares in Omega Corporation. Both corporations were to remain in existence. A meeting of the Alpha shareholders was set for December 1, 1994. Armstrong at that point demanded from Alpha Corporation the right to copy the shareholder list and to include in the proxy materials a statement in opposition to the sale because he thought the sale price was inadequate. Alpha Corporation's officers would only permit Armstrong to see the shareholder list, not copy it, and refused to include anything further in the proxy materials.

The notice and proxy statement were timely mailed to the shareholders of Alpha Corporation. Since Alpha Corporation's articles divided the shares into two voting groups on this matter, separate votes of the two classes of shares were held on December 1. The 100 class A shareholders split 50 for and 50 against the sale. However, the 10,000 public shareholders voted 9000 for the sale and only 1000 against. Based on these figures, the board intends to proceed with the sale.

Armstrong has just discovered that one of the Alpha directors owns 10% of the shares in the Omega Corporation, and that another of the Alpha directors (together with the 10% shareholder) serves on the Omega board. Although this information was disclosed to the Alpha board, the two directors serving on both boards voted on the transaction, and voted in favor of the sale. Furthermore, these facts were not revealed in the proxy materials.

Armstrong wants to have the sale of assets to Omega set aside, or at least get some relief against its directors. He has alerted you to the fact, however, that the articles of incorporation limit director liability "to the maximum extent permitted by Arkansas law." If the sale cannot be set aside, he wants to know if he can recover his investment from the corporation. Analyze Armstrong's alternative grounds of complaint based upon the principles discussed in this course.

Question II.

(33 points, 60 minutes)

Martin, Newman and Olson were the original incorporators of Ozark Truck Refurbishers, Inc.(OTR), a closely held corporation formed for the purpose of overhauling used trucks for resale. The Articles of Incorporation authorized 100 common shares with a \$100 par value and 1000 preferred shares with a par value of \$100. The common shares are subject

to a share transfer restriction set out in the bylaws and noted on the shares that requires prior approval by the board before the shares can be sold to a third party. The preferred shares have a dividend preference of 7% and a liquidation preference of \$105 plus accumulated dividends.

The three original incorporators each purchased five common shares for \$50 each. The rest of the common and preferred shares have been issued to other persons. No preferred dividends are currently in arrears.

The original incorporators also serve as the OTR directors and officers. Because the common shareholders have been complaining about the dividend policy, the board recently declared an extraordinary dividend of \$100 per share to the common shareholders. After payment of the dividend, the assets of the corporation were exactly equal to its liabilities. One of the preferred shareholders, appalled at this result, brought a derivative suit against the board on the basis that the dividend was improper. The board responded by adding two directors to the board (the articles granted the power to the board to vary the range of the board up to 5 directors). The two new directors were then designated as a special litigation committee to consider the derivative suit. Based on injury to public relations and the time and expense involved in such a suit, the committee after meeting three times and soliciting the advice of a local attorney has recommended that the suit be dismissed. The board on behalf of the corporation has therefore filed a motion to dismiss the suit.

Director Martin has decided that his best course is to abandon ship, and he asks your advice. He wants to resign as a director and officer and go into the refurbishing business on his own. He believes he could begin a refurbishing service for school buses through the contacts he has made working for OTR through the years. This type of refurbishing would be beyond the scope of OTR's business, and he indicates to you that OTR is not in a financial position to undertake such an expansion. Martin also intends to sell his common shares, and has located a potential purchaser. However, Newman and Olson have refused to approve the transfer.

Martin is concerned about any outstanding exposure to creditors, and about any liability to the corporation in the derivative suit. Advise Martin as to his potential liabilities and the legal ramifications of his proposed course of action.

Question III.

(17 Points, 30 Minutes)

Stuart and Thompson decided to form a two-person corporation to engage in business. Stuart and Thompson were to be the only shareholders and the only directors, and Stuart was to serve as President. Before the corporation was formed, the parties determined that they needed certain property surveyed. Stuart therefore contacted a surveyor and entered into Contract A on behalf of the corporation. She signed the contract, "Estee Corporation, a corporation to be formed which is to be the obligor, by Stuart, President."

The articles of incorporation were drawn up and signed at the attorney's office. The attorney told Stuart and Thompson that "everything is now go." Although Thompson realized that the articles needed to be filed, Stuart did not. Stuart therefore entered into separate Contract B on behalf of the corporation, which she signed, "Estee Corporation, by Stuart, President." The articles were not filed until two days later.

After the articles were filed, Stuart and Thompson at a board meeting caused Estee Corporation to specifically adopt Contract A. Stuart thereafter entered into a separate Contract C on behalf of the corporation, which she signed, "Estee Corporation, by Stuart, President."

Operations went smoothly until the second year, when Estee Corporation neglected to pay its franchise tax. During the period in which its charter was forfeited, Stuart entered into separate Contract D on its behalf. She signed Contract D "Estee Corporation by Stuart, President." When the franchise tax problem was subsequently discovered, Stuart and Thompson immediately caused the back taxes to be paid so that the charter has been reinstated.

Throughout the history of Estee Corporation, Stuart and Thompson have been careful to preserve its separate identity. As to each of the four contracts, discuss the potential liability of 1) Stuart; 2) Thompson and 3) Estee Corporation.

#### Question IV. Short Answer

(17 Points, 30 Minutes)

(points as indicated)

1. Harmon, one of the directors of XYZ Corporation, was a psychiatric patient of Dr. Irwin. During one of their therapy sessions, Harmon discussed his anxiety over an upcoming tender offer to be made by the ABC Corporation to the XYZ shareholders. Dr. Irwin conveyed this information to his friend, Jackson. Jackson immediately purchased 1000 XYZ shares at \$10/share. After the tender offer was announced, Jackson sold his XYZ shares at \$20/share, thus making a \$10,000 profit. What is the potential liability of Harmon, Irwin and Jackson under the federal securities laws? (6 points)
2. Arnold, Booth, and Clarence set up a business in which Arnold contributed 50% of the capital, and Booth and Clarence contributed 25% each. In year one, the business earned profits of \$36,000, which have not been distributed. What are the tax consequences to the business entity AND to the three individuals if the business was structured as:
  - a. General partnership, with no agreement as to the proportion of distributions.
  - b. Limited partnership, with Booth and Clarence as limited partners, profits to be

distributed on the basis of contributions.

c. C corporation (no S election), with common stock purchased proportionally to investment.

d. Limited liability company, with profits to be distributed per capita.

EXPLAIN YOUR CONCLUSIONS. (6 points)

3. Briefly define the following (in the context of this course):  
(5 points)

- 1) Regulation D
- 2) Pre-emptive rights
- 3) Mandatory share exchange
- 4) Fraud on the market theory
- 5) Short form merger