

Professor Matthews Exam. Number _____

Spring 1996 Graduating Senior? YES_____ NO_____

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 appropriately penalized.

2. All answers must be written in bluebooks (except as provided in #3). Please number your bluebooks, and write on only one side of each page. 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.

3. This exam may be typed using a manual typewriter, but no computers or memory typewriters are permitted. The exam shall be typed on paper provided by the law school.

4. When you are finished, turn in the copy of the test along with your answers, and label both with your exam identification number.

5. 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.

6. 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.

7. If any ambiguity or typographical error appears in any question, state the problem, make your assumption, and proceed accordingly.

8. 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(Approx)

I 33 60 min.

II 25 45 min.

III Short Answer A 18 30 min.

Short Answer B 24 45 min.

TOTAL 100 180 min.

I. Smith, Thomas, Unger and Vincent were equal shareholders in Sycamore Hill, Inc., a closely held Arkansas corporation formed for the purpose of developing a residential subdivision. The Articles of Incorporation for Sycamore Hill were duly filed on May 1, 1995, and authorized the corporation to issue 200 shares of \$100 par value common stock. The corporation issued 50 shares to each shareholder in `return` for \$2500 in cash and a promissory note for \$2500 payable May 1, 1998. Smith and Thomas were elected as directors, and have been holding regular director meetings since the corporation was formed.

Sycamore Hill, Inc. is now in severe financial straits, and Vincent has come to see you. He is very worried about his liability to numerous corporate creditors. First, he knows that Sycamore Hill borrowed a significant amount from First National Bank after its formation, and that he signed the note in some capacity. Second, he is concerned about a \$30,000 contract he entered into on behalf of Sycamore Hill on April 1, 1995 for the construction of roads by Roadco. He has brought you a copy of the contract, which he signed "Vincent, agent for Sycamore Hill, Inc., a corporation to be formed which will be the sole obligor on this contract." He believes that the road contract was approved by the Sycamore Hill board at their first board meeting in May of 1995.

Sycamore Hill has also engaged in several questionable transactions since formation. Vincent himself bought a lot from Sycamore Hill for \$10,000 with the approval of the board, but he thinks the property was worth perhaps \$20,000. He got the bargain because Sycamore Hill was desperate to sell some of the lots. Also, because Unger was experiencing financial difficulties, the board in October of 1995 authorized the repurchase of his shares for \$2500 and the cancellation of his note. Vincent is also uneasy about whether Sycamore Hill has been paying its annual franchise tax.

Vincent wants to know what records he should seek to provide information resolving his concerns. However, he has asked Smith and Thomas for access to corporate materials in the past and they have refused to give him copies or even access to the records.

At this point, Vincent would like to terminate his relationship with Sycamore Hill, Inc. He would like to sell his shares, which he believes would insulate him from any corporate liability. Washington has offered to purchase his shares for \$2000. However, the four initial shareholders entered into a shareholder agreement requiring that any sale be approved by the remaining shareholders. The agreement was never adopted as part of the Articles or Bylaws, however. Smith and Thomas refuse to agree to the sale.

In the alternative, Vincent would like to dissolve the corporation, recover his \$2500 initial investment, and let the creditors fight over the remainder. Advise Vincent as to his potential rights and liabilities. (1 Hour, 33 Points)

II. Film Manufacturers, Inc. (FMI) is a duly formed Arkansas corporation engaged in the manufacture of camera film. FMI has a board of five directors (Adams, Barnes, Carson,

Dawson and Edwards). Its Articles of Incorporation include a provision limiting the liability of its directors "to the maximum extent permitted by Arkansas law," but the corporation has adopted no provision regarding indemnification of directors. When the new model of cameras was recently announced, Director Adams brought up the possibility of providing a new version of compatible film in a discussion with the CEO of Kodeck Camera (a personal friend) at a cocktail party. Although Adam's overtures were favorably received, the new market was risky and FMI currently lacked adequate capital to undertake the project.

Director Adams raised the Kodeck project at a special meeting of the board held without advance notice on January 15, 1996. All five directors were present at the meeting, but Director Barnes objected at its start to the lack of notice. The board thereafter extensively discussed the project and its disadvantages. Director Adams frankly advised the board that he would pursue it on his own if the board did not. The board thereafter voted as follows: Adams, Barnes and Carson voted to reject the project, Dawson and Edwards voted in favor of it. Director Adams subsequently formed his own sole proprietorship, which has been profitably engaging in marketing the new film.

Shareholder Shasted acquired shares in FMI on March 1, 1996, when a court ordered a constructive trust placed on the shares as a remedy for Shasted in an unrelated lawsuit. Upon learning of the controversy, Shasted without further preamble on March 10 filed a derivative suit against Adams, Barnes and Carson. He claims that no rational business person would reach the board decision of January 15, and that Adam's profits belong to FMI.

FMI has responded to the lawsuit by forming a special committee composed of Dawson and Edwards to consider the merits of the suit. The committee has caused FMI to move for dismissal for failure to make the requisite demands, and on the grounds that the suit is not in the best interest of FMI. The three defendant directors are further claiming that they are entitled to mandatory advance indemnification for their cost of defense.

Evaluate the position of the various parties based on the legal principles discussed in this course. (45 Minutes, 25 Points)

III. Short Answer

Part A. (3 points each, Total 18 points)(Total 30 min.)

A. During the course of a psychiatric session with her patient, an officer of Abco, Inc., Dr. Denton learned that the source of his stress was a potential hostile tender offer for Abco. She immediately bought stock in Abco, which she sold for a profit. Has Dr. Denton committed a criminal violation of Securities Exchange Act Section 10(b) and Rule 10b-5? Is she liable in a civil suit to a contemporaneous trader?

B. A business enterprise makes a profit and distributes that profit to its investors. What is the federal income tax consequence to the enterprise and the investors if the enterprise is a) a general partnership; b) a limited partnership; c) a limited liability company; d) a regular C corporation (that is, NOT a subchapter S corporation).

C. Which shareholders are entitled to appraisal rights in a mandatory share exchange? Explain WHY the appraisal rights are apportioned in that manner.

D. Shareholders hold \$100,000 worth of common shares and \$200,000 worth of corporate notes. Outside creditors hold \$300,000 worth of debentures. How would application of the doctrine of equitable subordination change their priorities as to corporate assets? Explain.

E. Alpha Corporation was a closely held Arkansas corporation. In the past, President Lawrence had borrowed (without a corporate resolution) sums of up to \$5000 on its behalf from Financial Services. One month ago, President Lawrence executed a promissory note to Financial Services on behalf of Alpha Corporation for \$100,000. The proceeds were used to pay off corporate debts, but the board has taken no action in regard to the note. Is Alpha Corporation liable on the note? Explain your conclusion based on the agency concepts discussed in this course.

F. Porter is a shareholder in Investicorp, whose shares are traded on the American Stock Exchange. He has learned that Investicorp's management plans to propose a change in auditors for approval by the shareholders at their next annual meeting. He is opposed to the change in auditors, and would like to communicate his opposition to the other shareholders. He would prefer to have his statement in opposition included in the proxy materials paid for by management. Discuss his options under federal securities law.

Part B. (2 points each, Total 24 points)(Total 45 min.)

1. What is a "cash-out merger." Is it legal? Explain.
2. Quirk and Reynolds are the sole shareholders in a closely held Arkansas corporation. They want to enter into a shareholder agreement which will mandate that the board elect the two of them as officers of the corporation at designated salaries. They come to you to draft an enforceable agreement. What do you advise?
3. How has the enactment of the 1987 Arkansas Business Corporation Act affected the doctrine of de facto corporation?
4. What is the advantage of an incentive stock option over an unqualified one?

5. How does the standard of scienter differ between Securities Exchange Act Rule 14a-9 proxy fraud and Rule 10b-5? WHY is it interpreted differently?
6. What is the difference between a limited liability partnership and a limited liability limited partnership?
7. What is the distinction between Stated Capital and Capital Surplus in the pre-1987 Arkansas corporate statute?
8. "Staggering" is one defensive tactic to a tender offer. Explain why.
9. Efforts to discourage excessive executive compensation have taken several forms in the last few years. Explain.
10. Must a controlling shareholder share the control premium? Explain your conclusion.
11. RMBCA §14.30 provides that a court may dissolve a corporation on the grounds that the directors are acting or will act in a manner that is, among other things, "oppressive". How have the courts interpreted this word in the context of corporate dissolution?
12. XYZ corporation has 700 common shares outstanding and entitled to vote on the designated matter. 500 shares are represented at the meeting, and the vote is 201 for, 200 against, and 99 abstaining. Is the matter approved by the shareholders if it relates to a) an amendment of the bylaws? b) the sale of substantially all the assets of the corporation?