

Professor Matthews Exam. Number _____

Spring 1997

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 (sorry, Mr. Estes). 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 33 60 min.

III Short Answer A 21 40 min.

Short Answer B 13 20 min.

TOTAL 100 180 min.

I. Andrews is a shareholder, director, and officer in a small, closely-held Arkansas corporation named Arkprop, Inc. Arkprop was formed by the filing of Articles of Incorporation on January 15, 1996 for the purpose of developing a subdivision in Fayetteville. Arkprop has issued to each of its five incorporators (including Andrews) 200 shares of \$100 par value common stock in `return` for their initial investments of \$10,000 each. In addition, Andrews has made a loan of \$50,000 to Arkprop, for which he received a duly executed corporate note. The corporation is now in financial straits, and Andrews has come to seek your advice in regard to his potential rights and liabilities. He informs you about the following transactions:

1. In December of 1995, to prevent the site from being sold before the corporation was formed, Andrews contracted with the seller Xerxes to purchase the land for the subdivision for \$100,000. Andrews signed the contract "Andrews, as agent for a corporation to be formed". The contract provided that "The parties hereto specifically agree that said agent shall be released from liability at the adoption of this contract by said corporation." Arkprop's board of directors adopted the contract by resolution of February 1, 1996. Xerxes has not yet been paid.
2. Believing that the Articles had been filed the previous day, the incorporators met on January 6 and elected corporate officers. Andrews was elected Vice-President. On January 7, Andrews signed a contract on behalf of the corporation with engineer Young for engineering, surveying and platting services in the amount of \$100,000. Andrews tells you that he never received board authority to enter the contract, although the board knew about the services, which have since been rendered. Young has not yet been paid.
3. In March of 1996, Andrews was authorized by the board to contract for the purchase of season theatre tickets on behalf of Arkprop in the amount of \$1000. The purpose clause of the Articles of Incorporation clearly provides that "The purpose of this corporation is limited to the development of a subdivision, and any transaction beyond the scope of that purpose shall be invalid." The theatre has not yet been paid.
4. In September of 1996, Andrews was assisting the Arkprop dirt movers by operating heavy equipment. Unfortunately, he negligently injured potential purchaser Zerber, who has a \$100,000 tort claim.
5. In November of 1996, the board of directors (including Andrews) voted to permit a "draw" by each shareholder of \$5000 each. These amounts were therefore disbursed to the shareholders by corporate checks in January of 1997.

Andrews indicates to you that 1) he does not wish to pursue his fellow directors, and 2) he is uncertain whether the corporate franchise tax has been paid. Advise Andrews as to his potential rights against and liabilities to Arkprop and its creditors based on the principles discussed in this course. (33 points, 1 Hour).

II. Carter owns 5% of the shares in Alpha Corporation, an Arkansas corporation engaged in manufacturing toys. Carter purchased his shares for \$20,000 on March 1, 1997 in a privately negotiated transaction from Duncan, one of the five directors of Alpha Corporation. Carter is very unhappy about a transaction which took place shortly after he purchased his shares.

On March 15, 1997, the board of directors of Alpha Corporation voted 5-0 to approve a proposed purchase of substantially all of the assets of Omega, Inc., a local corporation manufacturing plastic toy parts. The only shareholders of Omega, Inc. were Duncan and three other Alpha directors, a fact revealed to the entire Alpha board. The terms of the sale provided that Alpha Corporation would purchase the assets by issuing to Omega, Inc. 10,000 of the currently authorized common shares of Alpha Corporation. Alpha Corporation would then assume all of the assets and liabilities of Omega, Inc., and Omega would thereafter dissolve and distribute the Alpha shares to its shareholders.

Carter, who believed that 10,000 shares was an exorbitant price to pay for the assets, immediately made demand on the Alpha board for access to its shareholder list in order to communicate with his fellow shareholders. He also asked to review the books of both Omega and Alpha corporations. Both requests were denied.

The Alpha board of directors thereafter decided to submit the transaction for approval of the Alpha shareholders. On April 2, the board therefore sent written notice that a shareholder meeting would be held on April 10. The notice identified the purpose of the meeting as the approval of the asset purchase. Despite the short notice, all shares were represented. At the meeting, the board disclosed that the shareholders of Omega, Inc. were Alpha directors, and Carter spoke against the wisdom of the asset purchase. With all shares voting, the vote was 51% in favor and 49% (including Carter's 5%) against approving the purchase.

The asset purchase was quickly carried out. However, Carter has since discovered that 10% of the shares voted in favor of the asset purchase were held by Duncan and the three Alpha directors who were shareholders of Omega. Since the asset purchase has reduced the value of Carter's shares, he is seeking some relief. Carter has compiled this list of possible remedies:

1. Renew effort to get access to shareholder list and records.
2. Recover the value of his shares before the asset purchase from either the corporation or Duncan.
3. Dissolve the corporation.
4. Set aside the asset purchase.
5. Make the directors pay damages to the corporation.

Evaluate the likely success of Carter's remedies, and any procedural steps required to institute the relevant suit, based on the principles discussed in this course. (1 Hour, 33 points)

III. Longer Short Answer (Total 21 points, Approx. 40 Minutes)

A. Porter is a shareholder in Investicorp, whose shares are traded on the American Stock Exchange. He wants to propose that the shareholders at the next annual meeting vote on a request that the board take steps to provide for cumulative voting in the election of directors. He would prefer to have his statement included in the proxy materials paid for by management. Discuss his rights under federal securities law. (3 points)

B. The directors of Arkco, Inc. made a disastrous decision to expand the corporate business into Mexico. Based on the time expended and the information available to the board, any court would find that the decision was made with gross negligence. A shareholder derivative suit has just been instituted against the board. Discuss the following issues based on the legal principles discussed in this course: (6 points)

1. The directors defend, expending \$10,000 in costs and attorneys fees, but a judgment is entered against them for \$50,000. The directors claim indemnity for both amounts from the corporation. Will they be successful?
2. The directors form a special litigation committee composed of two new directors, which recommends the dismissal of the suit. Will the court dismiss the suit?
3. The Articles provide that director liability is limited "to the maximum extent permitted by Arkansas law." Will the directors be successful in defending?

C. In each case, briefly compare and contrast the designated business entities in regard to the indicated characteristic:
(4 points).

1. Federal income taxation -- general partnership vs. corporation.
2. Liability -- limited partnership vs. Limited Liability Company.
3. Transferability of interests -- general partnership vs. corporation.
4. Entity status -- general partnership vs. corporation.

D. Harrison is planning on buying a 20% interest in a closely held Arkansas corporation. She asks you to evaluate the effectiveness of the following devices. Explain your conclusions: (8 points)

1. An article prohibition on the transfer of shares to insure that current shareholders remain the same.
2. A shareholder agreement which mandates that the board elect Harrison as President at a salary of \$25,000 per year.
3. An article provision that any shareholder has the right to dissolve at will.
4. A bylaw provision creating preemptive rights.

IV. Shorter Short Answer (2 points each, last one 1 point), Total 13 points; Approx. 20

Minutes)

Briefly EXPLAIN your answer to each of the following based on the legal principles discussed in this course:

1. Why is there a split among the circuits as to utilizing misappropriation as a remedy for insider trading?
2. Is the corporate ability to finance a project a prerequisite to classifying it as a corporate opportunity?
3. What are the advantages of a triangular merger over a straight merger?
4. Must a controlling shareholder share the control premium?
5. The proxy materials misstated a material fact which caused the minority shareholders to vote for the merger. However, the majority shareholders would have voted for the merger anyway. Has there been a violation of Rule 14a-9?
6. "Staggering" is one defense tactic to a tender offer. Explain why.
7. What is a shareholder "freezeout"? (1 point)