BUSINESS ASSOCIATIONS

PROF. MICHAEL

SAMPLE EXAMS

Warning and disclaimer:

The following are actual exam questions from past years. There is no guarantee, and you may NOT detrimentally rely on these exams as representing, that YOUR exam will look anything like this. The coverage of your exam will be proportional to the time spent on each subject or issue in class.

SAMPLE EXAM #1

Important Instructions - Read Carefully

Do not turn to the next page until you are told you may do so.

This exam consists of 16 questions worth a total of 60 points (60% of your final grade). Each question is worth the number of points indicated. You will have three hours to write your answers. Budget your time accordingly. You may answer the questions in any order, so long as you clearly indicate the number of the question you are answering.

Write all your answers in bluebooks. Write on every other line of every side of each page. Number your bluebooks consecutively and be sure your final examination number is on the cover of each one. Take your time to organize your answer before you begin to write. Write clearly and legibly.

You should apply general principles of partnership, limited partnership, limited liability company and corporation law as we have studied them in this class. If you believe that additional facts are necessary for a complete answer, clearly state the additional facts assumed and why you believe they are necessary.
Questions 1 - 6 relate to the following facts. [15 points total]

A, B and C agreed on Jan. 1, 1999 to form the ABC Laundromat. A wrote up the following agreement, which each of them signed on that date:

We will open a laundromat at 600 S. Limestone Street, known as the ABC Laundromat. We are using A's land and building. B will contribute 25 washers and 10 dryers. C will contribute $100,000 cash for start-up and operating expenses. We will share everything equally.

A owned the land and building at that address for many years. B had purchased the laundry machines with B's own money upon leaving a wholesale appliance business. C had extra money to invest. The laundromat opened for business on Feb. 1, 1999. It soon became successful, due to the apparently unmet demands of the otherwise unkempt college student population living nearby. On Feb. 15, C hired D to work as an attendant at the laundromat.

1. On Feb. 27, the laundromat is robbed of all its cash. C confesses to D that there is no money to pay him on Feb. 28, his first payday. D quits in a huff and sues C personally for his $600 wages due for his work in those first two weeks. What result? [3 points]

2. On Mar. 1, B hires E as the new attendant. Over the next few weeks, the business continues to flourish. E fancies herself as a successful entrepreneur, and tells all the customers that she, too, is a "partner" in the laundromat's business. She prevails upon B to increase her pay to include 2% of the weekly profits in addition to her regular wages. On Mar. 21, the Maytag salesman visits the laundromat. Having been told by A, B and C that E is "one of our partners," the salesman prevails upon E to order 5 new commercial washers, at a total cost of $4,500. When A discovers this, he immediately calls Maytag and repudiates the contract. On a suit by Maytag against the ABC Laundromat for damages for breach of contract, what result? [2 points]

3. A, B, C and E meet on Mar. 31 to figure the profits for March. E contends that she is entitled, in addition to her 2% bonus, to one-fourth of the profits, since A, B and C have consistently called her a "partner" over the last month. Despite the Maytag incident, A, B and C are generally pleased with E's work, but believe she is only entitled to her wages plus the 2% bonus for her work. Who is right? [2 points]
4. C discovers one morning that Wash-Mart, a national chain of franchise laundromats, is interested in opening a location near the campus area. Having an extra $50,000 to invest, C goes in on the Wash-Mart with other investors. When A and B discover that C is a partner in the Wash-Mart that is draining away their business, they claim they are entitled to share in C's profits. Are they? [3 points]

5. Would your answer to Question 4 be different if the laundromat were organized as a manager-managed limited liability company with E as the manager? [3 points]

6. When the business dissolves, can A get A's land and buildings back? [2 points]

Questions 7-9 relate to the following facts. [13 points total]

Hammer is CEO of Hammer Industries, Inc. (HII), a large, diversified manufacturing company. HII's shares are listed on the New York Stock Exchange (NYSE) (a national securities exchange).

Armand, a friend of Hammer's, is the chair of the National Benefit Foundation (NBF), a well-respected national charity. Armand convinces Hammer to contribute to NBF to support a major new relief drive for Kosovar refugees. On January 1, Hammer donates $2 million worth of HII stock, which she has owned for many years, to NBF, which then sells the shares over the next few days to various individuals at the prevailing NYSE market price. This deal is not significant in comparison to the daily trading in HII stock and none of the sales affect the market price.

On February 1, Hammer receives a report from HII senior executives of problems in one of HII's largest divisions. It appears that the division's managers have embezzled enormous amounts of money, and have slipped safely away overseas. Moreover, they may have also disclosed valuable HII trade secrets to HII's major competitors. Rumors among traders have sprouted, and HII stock's price begins to fluctuate dramatically with trading volume twice the average. The NYSE calls Hammer the next day to inquire about recent developments at HII that might account for the activity. Hammer discloses the embezzlement, but does not discuss the theft of trade secrets, hoping that HII rivals will be unable to successfully market competing products. Later that same day, Hammer's statement is publicly announced, and HII stock drops slightly but stabilizes.

On February 3, Hammer telephones Armand, and tells him about the trade secret theft. Hammer suggests that NBF hold on to the donated HII stock, as she doesn't want NBF's reputation to be tarnished by any tainted stock dealings. Hammer agrees to personally make good any loss so that NBF still receives the agreed $2 million. Armand informs Hammer that the stock has already been sold, and not to worry. However, on February 4, Armand tells his close circle of friends to sell HII stock, which they all do that same day. One thing leads to another, and by February 15, HII is forced to confirm rumors about the trade secret thefts. HII stock drops about 50% on disclosure of this news. Needless
to say, the relationship between Hammer and Armand sours appreciably on this turn of events. On February 16, believing that the market has overreacted to the disclosure of this information, Hammer then purchases large amounts of HII stock at the new lower price, hoping to donate future profits on the stock to charitable relief efforts other than those of NBF.

7. How might purchasers of HII stock from NBF recover their losses? [3 points]

8. How might purchasers in the market on February 4 recover their losses? [8 points]


Questions 10-12 relate to the following facts. [10 points total]

Gretchen is the owner of Chez Parnisse, a local restaurant and bar. She borrowed the money to buy the land and equipment from Bluegrass Bank, which holds a lien on all the business' assets as security. Chez Parnisse has been successful beyond Gretchen's ability to manage it, and she desires to limit her involvement in the business and her liability as well. She convinces Harvey to invest and manage the restaurant, and Irv to invest and manage the bar. Each of the three is to be one-third shareholder in and a director of CP Inc., and Harvey and Irv will be the officers.

Harvey then seeks to improve the restaurant, and convinces Bluegrass Bank to lend more money, secured by a lien on the new equipment and furnishings to be purchased with the second loan proceeds. He gives the Bank's lending officer a copy of the articles, a resolution showing his authority to borrow money, and CP Inc.'s financial statements. The loan is signed by Harvey for CP Inc. However, Harvey misunderstood what Gretchen had told him, and CP Inc.'s articles were actually not filed until the following week.

Following the incorporation, Irv takes immediately to his job managing the bar, but unbeknownst to Gretchen or Harvey, he has a book-making business on the side. He uses the bar as a front for his operations, and frequently siphons off money from the till to cover his gambling losses. Ultimately those losses lead to business problems, government investigations, and criminal fines against CP Inc., and those problems lead to default on the loans by Bluegrass Bank, which forecloses and sells the land and equipment. However, the proceeds from those sales are not sufficient to pay the entire loan balance. May the Bank recover the unpaid balance on either of the loans personally from:
10. Gretchen? [2 points]

11. Harvey? [4 points]

12. Irv? [4 points]

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13. [8 points] Parent Corp. has generated substantial losses for several years and expects to do so in the future. Parent owns 80% of the outstanding common stock of Sub Corp., a smaller but profitable corporation. All of Sub's directors are officers of Parent. Under the Internal Revenue Code, Parent and Sub may file consolidated income tax returns; thus, Parent's losses will offset all of Sub's taxable income, resulting in a substantial tax savings to Sub. However, Sub has agreed to pay to Parent 95% of the amount it would otherwise pay to the IRS if a consolidated return were not filed. Minority shareholders of Sub sue to rescind the agreement, claiming it is unfair, and that more of the tax benefit should be allocated to Sub. What result?

Questions 14-16 relate to the following facts. [14 points total]

General Nuclear Co. (GNC) operates nuclear power plants and produces radioactive metals for use and sale in nonmilitary applications. GNC is considering divesting its nuclear power plants because of potential future liabilities for accidents or injuries. But because these plants are profitable, GNC solicits the opinion of its shareholders at a properly-called special meeting. The sole question presented for the meeting is "Should GNC sell its nuclear power plants?" In the required proxy statement (since GNC's shares are registered under the Securities Exchange Act), GNC describes the general business, past profitability and risks of continued operation, but does not disclose that the company was recently sued by the residents of a small town near one of GNC's plants, who claim millions of dollars in injuries and costs from the plant's operations. At the meeting, 97% of the proxies are voted "no," and GNC's directors thereupon decide not to sell the plants, based primarily on the results of the vote. The suit by the town residents proceeds to judgment, and GNC is ultimately liable for enormous amounts, and the price of GNC stock declines sharply.

14. Is GNC liable to its shareholders who voted at the special meeting? [5 points]
15. is GNC liable to shareholders who purchased GNC stock after the meeting but before the judgment in the suit by the town residents? [2 points]

16. GNC directors have liability insurance against claims arising under federal law, but not for claims arising under state law. GNC has no charter provision limiting directors' liability. Should the directors be concerned? [7 points]

**Sample Exam #1 - Discussion of Issues**

Below is my summary of the major issues presented by each question and the most appropriate resolution for each.

1. There is clearly a partnership. C is individually liable for the partnership obligations (perhaps only jointly, many of you observed), if a partnership obligation was created. Did C have the authority to hire D? Was the action within § 9(1)? Probably. And if C did not bind the partnership, he is directly liable on the contract signed in his individual capacity, just like anybody else.

2. There are two theories relevant here. The relationship among A, B, C and E is not important here (that is the next question). The main issue is the representations made by the partnership to the Maytag salesman. Both UPA § 16 (partner by estoppel) and apparent authority apply here, and under either theory the partnership is likely liable for the $4500.

3. As among A,B,C and E, the question is whether E is a partner. You must discuss the factors in UPA §§ 6(1) and 7(4) here. Recall *Martin v. Peyton* and *Smith v. Kelley*. E is likely not a partner; there is a disproportionate sharing of profits as wages, but nothing more.

4. The relevant issue is *Meinhard*'s fiduciary duty. UPA §§ 20 and 21 help too, but only if there was partnership property involved. Was the new laundromat a partnership opportunity? It was the same business in the same area, but you must consider the language of the agreement; it referred to a specific business at a specific location. The better answer, I think, is that C was free to take this opportunity, but it is a close call.

5. Under ULLCA § 409(h)(1), C owes no duty as a non-manager member of a manager-managed LLC. C would be free to take the opportunity. An important distinction; that's all there is to the answer.
6. A is not entitled to get the land and buildings if they are partnership property. Most of you recalled that general rule. However, look at the agreement - it says "we are using A's land and building." Contribution of property, or rental?

7. There is no antifraud issue here because no one had any knowledge of the problems at HII when the sales were made. The best way for these purchasers to recover is rescission under Securities Act § 12(1). NBF took from an "issuer" (Hammer is so considered for this purpose) with a view to distribution, since resales were intended and planned; NBF is thus an underwriter. This is not an issuer offering under § 4(2) or Regulation D (Hammer is not an issuer for this purpose), nor is there an exemption under § 4(1), since NBF is an underwriter. There is nothing to suggest there would be any way to qualify under § 3(a)(11).

8. There are two distinct antifraud issues presented here. First, Hammer's and HII's disclosures were inadequate. The failure to disclose the trade secret theft must be analyzed in light of the disclosure about the embezzlement, all against the Northway standard. On the whole, the omission seems very material, especially in hindsight, when we see the price drop upon disclosure on Feb. 15. Purchasers on Feb. 4 can rely on the "fraud on the market" theory to supply reliance and causation. Second, Hammer and Armand used nonpublic information in their trading. It is clear that Hammer's disclosure to Armand is not tipping, because there is no hint of a personal benefit to Hammer from the disclosure (though you could invent one, and many of you did), even though it is clear Hammer meant for Armand to use the information in trading. Armand therefore cannot be a tippee, and is liable if at all only as a Dirks insider or misappropriator. Hence, there must be a duty owed by Armand to someone (NBF?) not to use this information. Under either theory, contemporaneous purchasers may recover under Exchange Act § 20A.

9. Many of you discussed Hammer's liability for nondisclosure, but the question asked about trading. None of the trading happened when the market was misinformed. Hammer faces the same Securities Act liability as NBF, probably (though this is a really advanced point). Hammer's "sale" on Jan. 1 and purchase on Feb. 16 would be subject to § 16(b), if indeed the gift can be considered a "sale."

10. Gretchen is liable on the first loan because she signed it; period. There may have been "adoption" by the corporation, but adoption doesn't get Gretchen off the hook; only a novation does that. There is no convincing theory suggesting Gretchen had an active part in the second loan; she didn't "act as a corporation," nor did she participate in Irv's shenanigans.

11. Harvey is not a promoter. He did not contract with the bank "on behalf of a corporation to be formed." His action is the classic defective incorporation. Under the MBCA analysis, he did not know there was no corporation, therefore he would not be liable. If you spoke non-MBCA words like "estoppel" or "de facto" that was given part credit too, but you must discuss the MBCA also.
12. Irv's actions probably breach director and officer duties many of you noted, but that is not liability that runs in favor of the bank. Veil-piercing was the argument obvious to most of you. The bank is a contract creditor, so "fraud" analysis is the most appropriate. Irv defrauded the bank by siphoning money and by conducting illegal operations. "Alter ego" analysis was used in a couple of answers, but "fraud" and "illegality" best describes the reasons to hold Irv personally liable.

13. This deal could be attacked in two different ways. First, it is self-dealing, because there are common directors on both sides of the deal. So it calls into question the Del. § 144 or MBCA § 6.31 or subchapter F rules. There was no independent director approval (impossible) or shareholder approval, so the burden is on the directors to prove "entire fairness" per *Weinberger*. Second, it is a parent-sub transaction, so the rules of *Sinclair* would be relevant. It is difficult to argue that Parent has gotten something to the exclusion of Sub since, absent the agreement, there would be no benefit for Sub at all. "Entire fairness" might suggest that some amount more than 5% be shared, but it is difficult to explain why. Any reasonable effort was given credit. There are many real cases based on these facts, and they are difficult to reconcile.

14. Everyone recognized that this question dealt with proxy fraud. The shares are registered under § 12, so § 14 and Rule 14a-9 apply. The disclosure was misleading, and materially so, per *Northway/Basic*. You need to explain why; a reasonable shareholder would want to know about existing litigation involving the plants because it would affect his or her decision on whether to sell them. Conclusory statements of the *Northway* test were not sufficient for credit. The most difficult issue is causation, however. Under *Mills/Va.Bankshares*, was the solicitation an "essential link" in selling the plant? Was it required by the directors? That's the theory argued in *Va. Bankshares*, but according to the Court, was not supported by the facts. Any reasonable argument received credit.

15. The proxy statement is a public document, and the misstatement could be actionable by traders in the market as well under Rule 10b-5. We need to establish materiality to a reasonable *trader* instead of a reasonable *voter*, but that should present little challenge. And we can again invoke "fraud on the market" to establish causation and reliance.

16. The directors should be concerned if they have possible liability that is not covered by insurance. What could that be? A state law claim. Some of you mentioned "blue sky" law or common law fraud, but duty of care is the main issue on these facts.

Consider first the prerequisite business judgment rule. No facts suggest the directors were not fully informed or were acting in bad faith. But did they have the corporation's best interests in mind? Indeed, is it even appropriate to ask the shareholders to decide this question? The law permits deviations from the basic model of corporate governance with closely-held corporations, but GNC is not one of those. The directors run the company, and it is inappropriate for them to delegate a decision like this to the shareholders. If we then look at the "fairness" test of *Technicolor*, it is difficult to analyze here, but the disclosure omission and the improper delegation will probably make a finding of fairness difficult.

Because this would be a suit in the corporation's behalf, the directors could receive only their expenses, and then only if they meet the "good faith" standards of MBCA § 8.51(a), according to MBCA § 8.51(d)(1). If they are wholly
successful, of course, they must be indemnified.

SAMPLE EXAM #2

Exam No. __________

Important Instructions - Please Read Carefully

Do not turn to the next page until you are told you may do so.

1. This examination consists of nine short-answer questions worth a total of 30 points, and 20 multiple choice questions worth a total of 30 points. You will have three hours to write your answers. [If you want to budget your time proportionately, you should allow approximately half the time for the multiple choice questions and half for the short-answer questions.]

2. Your answers to the short-answer questions must be written in bluebooks. Write on every other line of every page (front and back) of each bluebook. If you use more than one bluebook, number them sequentially on the front cover of each. Also write your final examination number on the front cover of each bluebook.

3. Your answers to the multiple choice questions must be written on the computer Answer Sheet. Read the instructions on the form completely. Enter your Final Examination Number in the space provided for "Student Number" on the form, beginning with the first block, and filling in the corresponding circles. Write your Final Examination Number where indicated at the top of this page now. You must turn in your copy of this examination with your Answer Sheet and bluebooks. If you do not do so, you will not receive credit for this examination.

4. Applicable law. If statutes are relevant to your answer, you may assume the following. Partnership: Unless the question asks about the difference between the UPA (1914) and the RUPA (1997), you can assume that it makes no difference which statute would apply. Other unincorporated entities: Assume that the RULPA and the ULLCA (1996) as they appear in your supplement are in force. Corporations: Assume that the MBCA as it appears in your supplement is in force, except that instead of §§ 8.60 - 8.63 on directors' conflicting interest transactions, the applicable law is identical to Delaware General Corporation Law § 144. In addition, assume that your jurisdiction will find decisions of other courts (including Delaware) persuasive in interpreting its statutes.

5. As with all your College of Law work, the Honor Code governs your conduct during this examination. By
submitting answers for grading, you certify that you have neither given nor received unpermitted aid during this examination, and that you have not witnessed any of your colleagues doing so.

MULTIPLE CHOICE QUESTIONS

Directions: Select the letter of the best answer from the choices provided, and darken the corresponding circle on your Answer Sheet. There are twenty questions; each worth 1½ points.

Questions 1 - 4 relate to the following common facts.

Dash, Tide and Cheer agreed that opening a new laundromat near campus would be a profitable venture. Dash obtained a commitment from Sudsy to lease a building near campus for a one-year term. The agreement was signed, "Cheer, on behalf of a corporation to be formed, which will be the lessor." A provision in the agreement obligated Cheer to use his best efforts to form a corporation and to have the corporation execute the lease agreement.

The three investors then formed "Clean Cat, Inc." They filed articles containing the minimum provisions required by law. Each contributed $1,000 in exchange for a one-third share of Clean Cat stock. They agreed that Dash would be the sole director and President, and that there would be dividends declared annually out of profits to the fullest extent permitted by law.

Consider the facts in each of the following questions independently.

1. Tide located a better site for the laundromat at a cheaper rent than the Sudsy deal, and the corporation repudiates the agreement with Sudsy. Sudsy sues Cheer for damages for breach of contract.

   A. Sudsy will win because Cheer signed the lease in his personal capacity.
   B. Sudsy will lose because he agreed to look elsewhere for performance on the lease.
   C. Sudsy will win because Cheer, as a promoter, is personally liable on the contract.
   D. Sudsy will lose because the corporation's decision to repudiate was protected by the business judgment rule.
2. Dash obtains a loan from Bluegrass Bank, and signs the loan agreement "Clean Cat, Inc., by Dash, President." The next day, the Secretary of State informed the three investors that the articles had not been approved for filing because the name they had chosen was already taken. They subsequently corrected the problem and filed articles under the name "Wildcat Wash, Inc." which were accepted. When Bluegrass Bank learned of the error, it repudiated the loan. Wildcat Wash sues Bluegrass Bank for damages for breach of contract.

A. Wildcat will win because Bank is charged with knowledge of public documents.

B. Bank will win because Dash bound the corporation when he signed.

C. Wildcat will win because Bank should be estopped from denying the corporate existence.

D. Bank will win because Dash was acting as a corporation knowing there was none existing.

3. The three shareholders agreed that no sale of shares would be permitted unless Dash approved. Over the years, Dash and Tide had a falling out, and each time Tide wanted to sell his shares to Ajax, who had made bona fide offers, Dash refused to authorize it. Which of the following remedies might Tide be entitled to?

A. voiding the transfer restriction as "manifestly unreasonable."

B. dissolution of the corporation on the grounds of illegality.

C. both (A) and (B)

D. neither (A) nor (B).

4. Assume that the jurisdiction of incorporation has not adopted MBCA § 7.32 and that its version of § 8.01 simply reads "The business of a corporation shall be run by or under the direction of a board of directors." Which of the following provisions of the shareholders' agreement would a court most likely find objectionable?

A. the election of Dash as director.

B. the appointment of Dash as President.

C. the declaration of the maximum allowed amount of dividends.

D. the agreement to each subscribe for one-third of the stock to be issued.
Questions 5 - 9 relate to the following common facts.

Parent Corp. owns 90% of the common stock of Sub Corp. The two corporations have no common directors, but the Sub Corp. directors are all (non-director) officers of Parent Corp. The two corporations have reached the following agreements:

I. Sub Corp. will declare no dividends.

II. Sub and Parent will file consolidated income tax returns, and Sub will pay to Parent 90% of the tax savings it will realized by filing the consolidated return.

III. Sub and Parent agree that Parent will never sue the directors of Sub for any breach of duty in their capacity as directors.

5. Which of the agreements is most likely valid under the reasoning in Sinclair Oil Corp. v. Levien?

A. I
B. II
C. III
D. All would be equally likely to be valid.

6. Which of the agreements is most likely unfair based on the "unfair price" portion of the fairness test of Weinberger
v. UOP, Inc.?

A. I
B. II
C. III
D. All are equally "fair" or "unfair"

7. Which of the three agreements most likely exposes the directors of Parent Corp. to liability for breach of their duty of loyalty?

A. None of them exposes the Parent Corp. directors to liability.
B. I
C. II
D. III

8. Assume, without deciding, that one of the agreements results in liability of Parent Corp. directors to the corporation in a derivative suit for breach of duty of loyalty. May the directors be indemnified?

D. Yes, but only for reasonable expenses and only if they acted in good faith and in the corporation's best interests.
C. Yes, but only if the Parent Corp. has so provided in its articles.
A. No, because indemnity would nullify the recovery by the corporation.
B. No, because the directors received an improper personal benefit.

9. Parent Corp. decides to "cash out" the Sub Corp. minority shareholders for $10 cash per share. Which of the following additional facts would be most damaging to the Parent Corp. directors in defending a suit for breach of duty of loyalty?
A. An independent investment banker appraised the shares at $17.

B. Sub Corp. has no "independent" directors.

C. Sub Corp. directors were not told of the appraisal in (A).

D. Sub Corp. directors were essentially required to negotiate with their employers.

* * * * *

Questions 10 - 16 relate to the following common facts.

Hall, Gibson and Scrooge formed a general partnership to print custom greeting cards. Hall and Gibson each invested $10,000, and Scrooge contributed printing machinery worth $20,000. The three agreed to split any profits equally. The company solicits small individual and family orders through advertising in national magazines and on the internet. Hall and Gibson handle the advertising, marketing, development, and billing. Scrooge keeps to himself in the print shop and only handles production.

Consider the facts in each of the following questions independently.

10. A potential new customer stops Scrooge as he is on his way to the print shop one morning. Scrooge invites him in, explains that he only runs the print shop but would be glad to show samples of the firm's work. The customer is impressed and places a large order. Unfortunately, Scrooge has little experience in such matters and accidentally uses the 1995 price list, which makes the order very unprofitable to the firm. Hall later finds out and calls the customer to cancel the order. In a suit by the customer against the partnership for damages:

A. the customer will win because Scrooge had actual authority.

B. the partnership will win because it was unreasonable for the customer to assume that Scrooge had authority to bind the partnership.

C. the customer will win because Hall and Gibson left Scrooge in charge.
D. the partnership will win because Scrooge's authority to take orders was revoked when he decided to work only in production.

11. Assume the same additional facts as in question 10, but instead assume (for this question only) that the business was organized as a manager-managed Limited Liability Company with Hall appointed as the manager. In the same suit by the customer against the LLC for damages:

A. the customer will win because Scrooge had actual authority to bind the LLC.
B. the LLC will win because only Hall had actual authority to bind the LLC.
C. the customer will win because Scrooge had apparent authority to bind the LLC.
D. the LLC will win because Hall had no authority to cancel the contract once it had been accepted by Scrooge.

12. Hall books a large order from a customer for holiday cards. However, Gibson refuses to book the customer's subsequent order for Independence Day cards because he finds the customer personally objectionable. In a suit by the customer against the partnership for damages for breach of contract,

A. the customer will lose because Gibson has authority to bind the partnership
B. the partnership will lose because Gibson has authority to bind the partnership
C. the customer will lose because he has no entitlement to continued business with the partnership.
D. the partnership will lose because Hall's course of dealing can only be changed by a majority of the partners.

13. The partnership concludes its first year of operations with a loss of $30,000. Scrooge wants to have the partnership liquidated. Is he entitled to do so?

A. No, because no one has dissolved the partnership.
B. Yes, because partnerships are terminable at will unless otherwise agreed.
C. No, because there is an implied agreement to continue the partnership until there is a reasonable expectation of profits.
D. Yes, because under UPA § 32(1)(d) the business can only be carried on at a loss, or under RUPA § 801(5)(i) the economic purpose has been frustrated.
14. The partnership concludes its first year of operations with a loss of $30,000. Assume that a creditor of the partnership has successfully sought a liquidation. There remains $10,000 to be distributed to the partners after all the creditors have been paid. According to the UPA, now what happens?

A. Hall, Gibson and Scrooge divide the $10,000 equally (as equally as possible).
B. The partners share the $10,000 according to their relative capital contributions, so Hall and Gibson each get $2,500 and Scrooge gets $5,000.
C. Scrooge gets the whole $10,000.
D. Scrooge gets the whole $10,000 and is entitled to collect $5,000 each from Hall and Gibson.

15. The partnership concludes its first year of operations with a loss of $30,000 but is not liquidated by a creditor. Instead, Hall and Gibson determine that Scrooge's inept production and sour demeanor have made profits impossible. May either Hall or Gibson have the partnership liquidated and recover further damages from Scrooge for injury to the business caused by his conduct?

A. Yes, but only under UPA § 32(1)(c), not under RUPA.
B. Yes, because the partnership is at will.
C. No, because they are equally at fault.
D. No, because their dissolution would be in contravention of the partnership agreement.

16. Over the years Scrooge becomes even more curmudgeonly and antisocial. Hall and Gibson would like to expel him and find someone else with whom to continue the business. May they do so?

A. No, because the partnership agreement does not provide for expulsion.
B. Yes, because any partner may dissolve an at-will partnership at any time.
C. No, because the partnership agreement does not provide for continuation of the business once Scrooge leaves.
D. Yes, but Scrooge will have the right to have the partnership liquidated and can bid for the assets in competition with Hall and Gibson.
17. S was sold a bum deal. There were no misrepresentations; she just made a bad investment. Which of the following additional facts would by itself be most damaging to her ability to recover under § 12 of the Securities Act of 1933?

A. The purchase price of her investment was under $1 million.
B. The investment was a share in a member-managed LLC.
C. She is a resident of the same state in which the issuer is incorporated.
D. She meets the requirements for an "accredited investor."

18. X Corp. sold $5 million worth of shares to 50 of its employees three months ago in an offering exempt from registration under Rule 506. Now X Corp. would like to sell a total of $500,000 worth of new shares to its 5 top executives in reliance on Rule 504. Which of the following will be relevant in determining the availability of the Rule 504 exemption?

A. Both aggregation and integration
B. Neither aggregation nor integration
C. Aggregation but not integration
D. Integration but not aggregation.

19. L, M and N are individuals. They want to go into business as the sole co-owners and managers of a limited liability entity that pays no federal income tax. Each wants to be assured of having full authority over every aspect of the business. In addition, N wants to be allocated first rights to any distributions, if there are any. Which of the following entities will meet their requirements?

A. A limited partnership.
B. A limited liability partnership.
C. A manager-managed limited liability company.
D. A corporation.
20. P, R and S are individuals. They want to go into business as the sole co-owners of a limited liability entity that pays no federal income tax. Each wants to be assured complete legal freedom to transfer his or her entire ownership interest without limitation. In addition, R is a nonresident alien. Which of the following entities will meet their requirements?

A. A limited partnership.
B. A limited liability partnership.
C. A manager-managed limited liability company.
D. A corporation.

**END OF MULTIPLE CHOICE QUESTIONS**

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

1. A is not true.
B is the best answer
C is not correct; Cheer has performed his contract; he did not sign a lease
D is a nonsequitur.

2. A not relevant
B is not true; Dash cannot bind a nonexistent principal
C is the best answer
D is not true; Dash did not know there was no corporation

3. A best answer
B is grounds for permissive judicial dissolution, and besides there is nothing "illegal" here in that sense; "oppression" would be the more likely candidate.

C no, since A is best
D no, since A is best

4. C goes the furthest to intrude upon the traditional role of the board of directors, much more so than A or B. D is not an agreement which binds the directors in any fashion.

5. I is like the decision in Sinclair not to declare dividends, which was found not objectionable, so A is the best answer.

6. I and III really have no "price" element to their "fairness." II certainly does, and although it is difficult to predict the answer, "unfair price" is clearly more relevant here, so B is the best answer.

7. III is clearly motivated by the Parent directors' concern for liability on the part of their subordinates and is in direct conflict with their role as shareholders in Sub, so D is the best answer.

8. A is true but incomplete; they may still be reimbursed for expenses.
B is not true.
C is not true; see D
D is the correct reading of § 8.51(a) and (d) and is the best answer.

9. The issue is what would be "fair dealing" and "fair price" under Weinberger.
A clearly implicates the "fair price" and is the best answer.
B does not make it impossible to negotiate at arms' length if no one is on both sides of the bargaining table.
C clearly implicates "fair price," but is not "unfair dealing" unless Parent is obligated to disclose this fact to Sub, which it is not.
D does not make it impossible to negotiate at arms' length, but rather only hints at a self-interest; it is the second-best answer, but A is better.

10. A is the best answer
   B since A is true, the customer's assumption is irrelevant.
   C goes to apparent authority and is incomplete; actual authority is better.
   D is not true; authority is not unilaterally limited in this fashion.

11. A is not true in a manager-managed LLC.
   B is true but doesn't preclude liability based on apparent authority.
   C is the best answer.
   D assumes the existence of apparent authority which is the real issue.

12. A is incorrect because the premise is untrue; see D
   B is incorrect because the premise is untrue; see D
   C is not relevant and may be untrue in any event
   D is the best answer, this is like *Covalt v. High*.

13. A his request for dissolution *is* an event of dissolution or dissociation and liquidation,
   since this is a partnership at will
   B best answer under either UPA or RUPA
   C the facts do not support this
   D the facts do not support this either and, in any event, § 32 and § 801 dissolution is available only upon petition to a court

14. A only if capital has been paid back, which it has not
   B no; surplus is shared equally if capital has been paid back, which it has not
C correct; capital is paid first
D no; Scrooge is due only $10,000 because he must bear his 1/3 share of the loss.

15. A is the best answer
B is not true under RUPA
C is not true in any event
D is also not true

16. A is true in that Scrooge may not be expelled, but they could still dissolve
B is true but not as complete as D
C is true but such an agreement is not required.
D is the best answer.

17. A is not dispositive; there could be other offerings to be integrated
B is the best answer; this means there is no security, so exemptions become irrelevant
C is incomplete; § 3(a)(11) requires the issuer to be doing business in the state as well
D is not dispositive; if the exemption fails, all investors could recover.

18. A is not true because aggregation is not relevant; see C
B is not true because integration is relevant; see D
C is not relevant because the prior offering will not be aggregated; it was not in reliance on a § 3(b) exemption or in violation of § 5.
D is relevant, as it is in any set of facially discrete offerings

19. A does not provide full authority or sole ownership and limited liability.
B is the best answer
C does not provide full authority
D does not permit N's "preference" and beneficial tax treatment under Subchapter S.

20. A same as question 19
B does not provide free transferability of the entire interest; the transferor still remains a partner
C is now the best answer, since they are no longer interested in full authority
D would be equivalent to C, except R may not be a shareholder if the corporation is to receive beneficial tax treatment under Subchapter S.

SHORT ANSWER QUESTIONS

The number of points allocated to each question is indicated in brackets following the question.

Questions 1-5 relate to the following facts.

Bidder Cosmetics, Inc. (Bidder) and Target Beauty Corp. (Target) agreed to merge. The agreement was concluded on April 27 and announced on May 1, 2001. During the last two weeks of April, both companies' boards of directors had been negotiating over the final merger details, including the price. It was ultimately settled that each share of Target would, upon the effective date of the merger, become one share of Bidder. At the April 27 market prices for each company's common stock on the New York Stock Exchange where both are listed, that would be a premium of about 25% over the current market price for Target shareholders.

Common is a director of both Bidder and Target, but he was not involved in the negotiations and abstained from voting when the merger was presented to both Bidder and Target boards in separate meetings on April 29.

Tattler was a Bidder director who believed that the merger with Target will be bad for Bidder. She voted against the merger at the April 29 meeting. After the meeting, she telephoned her friend Drake, a reporter for Cosmetics Daily, the trade newspaper that covers both Bidder and Target, to tell him about the planned deal and the pending disaster for Bidder. She did not mention Target nor the proposed merger price. Drake prepared his report for the newspaper and sold all his Bidder shares that same day, as did Tattler. Cosmetics Daily strictly prohibits trading by its reporters in the shares of companies under current investigation by the paper.
On the morning of April 30, Darke's story appeared in *Cosmetics Daily*. The story was met with "no comment" by officials from Bidder, which had been Bidder's only reply to press inquiries during the past two weeks. In trading on April 30, the price of Bidder's stock dropped significantly.

On the evening of April 30, Tattler had dinner with her husband and told him that "this may be a disaster for Bidder, but Target, the company we are merging with, well, those shareholders will make out like bandits." Orders for substantial amounts of Target stock were placed on the morning of May 1 by Tattler's husband, as well as by Waiter, the server at the restaurant who had overheard Tattler's statement.

On the afternoon of May 1, the merger was officially announced. The price of Target stock jumped immediately on the news. The next day, both corporations sent out a joint proxy statement to their shareholders seeking approval of the merger. Under state law, approval by Bidder stockholders was not required, but one of the terms of the deal, at Tattler's insistence, was to put the merger to a vote of Bidder shareholders. Common's position on both boards was not disclosed to the shareholders. Nonetheless, all other facts about the deal were disclosed, and the shareholders of both corporations approved the merger at separate shareholders' meeting on June 1.

As it turns out, the new combined Bidder Cosmetics did not have good fortunes. Many of the cosmetic and pharmaceutical products purchased in the Target deal were ineffective or illegal infringements on patent medicines owned by other companies. Subsequent investigation by Darke, at Tattler's urging, disclosed that Bidder board members were never told of Target's problems, nor did they investigate them. As it turns out, the Bidder board was enamored with the idea of acquiring one of their main competitors, and had approved the deal despite management's protests. On July 1, Darke's latest expose ran in *Cosmetics Daily*. Bidder's stock dropped significantly to record lows. Although Tattler found great delight in being vindicated, she believed that the market had overreacted to the news, and purchased Bidder shares at what she called "fire sale"prices.

* * * *

1. Discuss the liability, if any, of Bidder Cosmetics to traders in the market for Bidder shares during late April. [3 points]

2. Discuss the liability, if any, of either Bidder or Target to their shareholders who voted on the merger at the June 1 shareholders' meetings. [2 points]
Questions 6-9 relate to the following facts.

Returns.com, Inc., is a closely-held corporation with 5 shareholders: A, B, C, D, and E. Pursuant to a shareholders' agreement, they have elected B and C directors and operating officers. Band C are to operate an "e-commerce" business. There is no agreement or provision restricting the scope of the company's business. The five stockholders invest $60,000 in the business.

B learns one day that Worldwide Web, Inc.(WWI), is looking for strategic partners in its new ventures into e-commerce. B and C form a partnership and have the partnership sign up as a "WWI e-commerce Partner." The two arrange to have Returns.com make substantial cash distributions, as permitted under the shareholders' agreement, so that they can make significant investments in the partnership.

Although neither B nor C agreed to work full-time for Returns.com, their interest in the company wanes as the WWI venture becomes more lucrative. Further requests by A, D and E to have the corporation make distributions have gone unheeded by B and C, although Returns.com has been profitable, and B has sold some of his shares back to the corporation. A, D and E are suspicious that, while Returns.com has been profitable despite the minimal attention of its managers, the trend cannot continue. They would like to have Band C removed, but their shareholders' agreement does not provide for that.
6. Are B and C liable for their actions either to Returns.com or to A, D and E? [6 points]

7. Could A, D or E have Returns.com, Inc. dissolved? [2 points]

8. How would your answers to questions 6-7 be different, either in analysis or result, if Returns.com were a partnership instead of a corporation, the shareholders' agreement were a partnership agreement, and B and C were managing partners instead of directors? [5 points]

9. Suppose, independently of your answers to questions 6-8, that events continue to unfold. Returns.com, Inc. is unable to pay IBM for computers purchased, and it turns out that the website C designed for Returns.com was copied from Amazon.com's website in violation of copyright law. The resulting liabilities far exceed Returns.com's net assets. Would either B or C be personally liable for these amounts? [3 points]

END OF EXAMINATION

ISSUES RAISED IN SHORT-ANSWER QUESTIONS

[allocation of points appears in brackets in some discussions below]

1. 10b-5 antifraud. Clearly the impending merger is material under Basic; however, "no comment" is OK so long as no mandatory disclosure came up. The Cosmetics Daily article did not require a response. No liability.

2. Proxy fraud. The omitted information (the Common director) is material in the Northway sense, but it does not satisfy the Virginia Bankshares causation test because the merger was approved by disinterested majorities anyway. No "loss of state remedy" here. As to Target shareholders, there is garden-variety Mills causation, so Target would face liability here. I'm not sure for what, since Target shareholders had no damage, but that's not often the centerpiece of a proxy fraud lawsuit.
3. There is clearly a duty of care problem here. The directors generally were more enamored with taking over a competitor than investigating its shoddy products. Not being fully informed will rebut the BJR, and the burden will be upon them to show that the dealing and price were fair. The dealing looks pretty good; they kept Common out of it. The price is hard to say; just because it's a substantial premium doesn't necessarily make it fair, recall *Van Gorkom*.

Tattler faces no duty of care liability, since she voted "no," but she has duty of loyalty problems even if there was no personal gain sufficient to make the "tip" to Drake actionable (see question 3), but not under any specified theory. She clearly is liable, however, under Section 16(b) for the sale on April 29 matched with the lower-priced purchase on July 1.

4. Tattler is a "classic insider" because she sold her Bidder shares. The fact that the purchaser may not have previously owned shares makes no difference under Rule 10b-5. Darke's liability could be based either on tipping or misappropriation, but the latter is clearly the better argument. Tattler has no tipping liability to traders if she breached no fiduciary duty to Bidder, which is measured by any "personal benefit" she received from the tip. There appears to be none here. The smug satisfaction of letting the cat out of the bag probably isn't enough even under the most generous test. If she has no liability, Darke has none either on this theory. But he is a misappropriator by breaching his duty owed to *Cosmetics Daily*, which he agreed to by working there. Rule 100 is not relevant to the answer; it would impose liability only on Bidder.

5. Tattler's husband faces the job of rebutting the presumption laid by Rule 10b5-2, but it shouldn't be difficult if there had been no prior discussions. Waiter, of course, is just plain lucky; he owes no duty to the source of the information.

6. They have taken a corporate opportunity regardless of how they learned about the information because they are senior executives. It should have been first offered to Returns.com. [2] There is probably a duty-of-care argument to be made, but Returns.com continues to be profitable despite the directors' neglect. [2 points] There is a Donahue style freeze-out going on here as well, given the early dividends, the later refusal, and the repurchase of B's shares. [2]

7. This will turn on whether B and C are acting "oppressively." Are they defeating A, D and E's "justifiable expectations"? This is more difficult with a shareholders' agreement appointing them "directors and officers for life," no? [2]

8. The corporate opportunity is likely a partnership opportunity as well, since there was no limited "course of business." [2 points] The other activity, while contemptuous, may not be unlawful separately, despite the "punctilio of an honor most sensitive," because it is overshadowed by the dissolution issue. A, D and E may dissolve the Returns.com partnership at any time, and even if that might otherwise be in breach of the partnership agreement, B's and C's actions constitute grounds for dissolution under UPA § 32(1)(c) or (d) or RUPA § 601(5) making A, D or E's dissolution not wrongful. [3]
9. This is a veil piercing question. IBM -> contract factors, fraudulent transfers made. [1] Amazon -> tort factors, there would be no liability insurance nor any way to judge if capital is relevant. [1] Note that VP here is only an issue for B; C retains direct liability for his acts. [1]