Business Associations
Final Examination

Professor Campbell

THE FOLLOWING ARE REPRESENTATIVE QUESTIONS FROM OLD EXAMINATIONS.

Question 1
65% of your grade

Alpha Corp. is the investment vehicle for the Adams family. For some time, Andy Adams, the defacto head of the Adams clan, has had his eye on Beta Corp. Over the last few months, Beta has been selling at about $10 per share. Six months ago, Andy Adams hired Ketchem & Cheatham, an investment banking firm, to evaluate Beta. Ketchem & Cheatham reported that Beta, if restructured, could fetch as much, as $25 per share. The restructuring would require the sale of two substantial divisions of Beta, which, in the view of Ketchum & Cheatham, constituted a drag on the earnings of Beta.

Bill Begley, the CEO of Beta, is a personal friend of Adams', so Adams called Begley to inquire whether there may be some interest in a merger between the two companies. Adams suggested a merger of Beta into a newly created, wholly owned subsidiary of Alpha. Each Beta shareholder would receive cash and debt valued at $13 per share. Adams emphasized that the price represented a 30% premium or market value. Begley said he was interested and would think it over.

The very next day, Begley was confronted with a startling fact. Carl Couch filed a Schedule 13D, indicating that he was the owner of approximately 7.5% of the common stock of Beta. The Schedule 13D also indicated that Couch may attempt to acquire control of Beta. Subsequently, Begley met with Couch, who informed Begley that he intended to make a cash tender offer for Beta at $14 per share. Couch said that he had faith in Beta and intended to run the company "as is", with no changes in structure or management.

Although this sounded fine to Begley, there was one problem. Begley hated Couch's guts. He would sell his company to Adolph Hitler before he would sell to Couch.

Begley, therefore, immediately informed Adams, who moved into action. First, Adams caused Alpha to begin purchasing Beta stock on the market, purchasing...
approximately 4% of Beta stock over the next few weeks. He also told his brother-in-law about what had happened, and his brother-in-law, with the encouragement of Adams, purchased about 1% of Beta’s stock. They were able to make their purchases at an average price of $12 per share.

At the same time, Adams caused his lawyers to draft a merger agreement between Alpha Beta. Under the terms of the agreement, Beta would be merged into a subsidiary of Alpha, and the Beta shareholders would receive cash and debt of Alpha valued at $15 for each share of Beta stock. Also, the merger agreement obligated Beta to issue Alpha an option to purchase 1 million shares of Beta stock (which would represent approximately 20% of the outstanding stock after the sale), the option to be exercisable at the price of $12 per share.

Adams, shortly thereafter, met with Begley and went over the terms of the proposed merger. Begley said it looked fine to him. Later that day, Begley personally called each Beta director and announced that there would be a directors’ meeting in three days to consider the merger. This was the first the directors heard of the merger. Begley said that in preparation for the meeting he would send the directors by overnight mail a copy of the proposed merger agreement.

Only four of the nine directors of Beta were able to attend the directors’ meeting. A fifth director, however, participated in the meeting through a speaker phone. At the meeting, Begley disclosed Couch’s offer for the company, but he said he favored the Alpha proposal for a number of reasons. First, he thought Couch was incompetent to run the company. Second, he believed that Beta had become unwieldy and needed to be restructured. He thought spinning off the divisions, therefore, was sensible. A couple of directors remarked that they thought $15 per share was a nice price for a company selling for only $12. The directors approved the merger and agreed to submit the matter to shareholders at a special meeting. At the same time, the board of Beta announced publicly the approval of the merger.

Management of Beta then set about preparing for the shareholders’ meeting and drafting proxy materials. Although the proxy materials were exhaustive and drew no comments from the SEC, nowhere did the materials describe the intent of Alpha to spin off the two major divisions of Beta after the merger or Couch’s interest in acquiring Beta.

The proxy materials and the notice of the shareholders’ meeting were sent to shareholders of Beta on November 1. The meeting was held on November 19.

At the meeting, a number of disputes arose. Management claimed to have proxies representing 53% of the outstanding stock that approved the merger. Mr. Epstein, however, claimed that 4% of the total outstanding shares were subject to a voting agreement authorizing him to vote on behalf of the shareholders. Mr. Frank,
who purchased shares in Beta after the record date, also proposed to vote the shares he purchased. He produced properly executed stock certificates transferring ownership of the shares to him and a document from the seller (the record owner of the shares) authorizing Frank to vote the shares. If both Mr. Epstein and Mr. Frank were permitted to vote the shares in question, they indicated they would vote against the merger, and management would have proxies for only 48% of the outstanding shares.

Begley, who was presiding at the shareholders' meeting, ruled that neither Epstein nor Frank were entitled to vote the shares in question, and so the merger was approved.

Discuss the legal issues raised by these facts.

**Question II**

35% of your grade

Approximately three years ago, Ms. Smith was given the opportunity to acquire 8 operating oil wells in Eastern Kentucky. Although Ms. Smith is a bright and capable woman, she had neither the capital nor the operational expertise to acquire and run the wells.

She asked Mr. Thomas whether he would like to join her in the acquisition. Mr. Thomas indicated that he would be interested in participating in the acquisition, but only through T Corp., a closely held corporation in which he owned 42% of the voting stock. Mr. Thomas stated that he had sufficient control of T Corp. and its board to ensure T Corp.'s participation. Also, although T Corp. was highly leveraged, the company had not exhausted its line of credit. Mr. Thomas thought, therefore, that T Corp.'s contribution would be easy to finance.

The key to make the transaction work, however, was Mr. Utley, who had both capital and the capability of operating the oil wells. At first, Mr. Utley was reluctant to participate in the project, but he later reconsidered and agreed to participate in a somewhat limited way.

Initially, therefore, the following terms were agreed upon among the parties. Ms. Smith and T Corp. would be general partners. Each would contribute capital of $150,000 in cash. Mr. Utley refused to become a partner, but he did agree to loan the partnerships $500,000. Utley was to be paid interest on his loan at 1% below prime rate and was to receive, in addition to that rate, 5% of the profits from the sale of the oil. Also, Utley was to receive an additional 5% of the profits for his management services. In that regard, Utley agreed to operate the wells and market the oil for the partnership. Utley also rented storage facilities to the partnership for $3,000 per
month.

Things went great during the first year. During the second, however, things began to get ugly. Oil prices dropped significantly, and the partnership began to have trouble paying its debts. At the beginning of the third year, Utley died unexpectedly. At the time of his death, the partnership owed Utley $50,000 for unpaid rentals on the storage facilities.

When Utley died, Smith assumed control of the situation quickly. She found things to be a mess. The Partnership owed creditors $600,000, in addition to the $50,000 debt claimed by Utley (and then his estate). Because of a decrease in the price of oil, value of the partnership's oil reserves had decreased to approximately $500,000. Smith, nonetheless, believed that the situation could be salvaged, and she, without consulting Thomas or T Corp., moved into action. First, she informed Utley's estate that she repudiated the claimed $50,000 debt, alleging that the rental of $3,000 per month was "gross and outrageous" and thus not a legal and binding obligation. Next, she concentrated on lowering the costs of oil production. She purchased on behalf of the partnership equipment to modernize the partnership's drilling operations. The equipment was purchased on credit from Acme Co. for a downpayment of $10,000 and a balance of $190,000 to be paid over three years.

Shortly thereafter, Thomas learned of the death of Utley and of the actions of Smith.

Thomas comes to you for legal advice. He is particularly concerned about any liability that he or T Corp. may have, any claims he may have against Smith and what steps he can take to terminate any future liability against himself or T Corp.