Business Associations
Sample Exam 2

QUESTION 1

Sox News is the most trusted name in news—and more importantly for its shareholders, the most profitable name in news. Sox’s superstar broadcaster, Anderson O’Maddow, has long been the lynchpin of its advertising strategies, with his name and likeness blazoned on every billboard, bus, and commercial in sight. His show “Morning O’Maddow” airs five days a week and is the highest-rated show on cable news. The full name of Sox News is Sox News, Inc., and it is a public company incorporated in the state of Delaware. Its annual revenue is approximately $2 billion, about $250 million of which is directly or indirectly linked to O’Maddow’s show, whether through advertising money or through fees paid to the network by local affiliates throughout the country.

On March 7, 2017, however, a huge news story broke. It turns out that O’Maddow had engaged in a long course of horrific conduct toward pretty much everyone unlucky enough to catch him on a bad day. From screaming vicious insults at staff members who failed to polish his cufflinks, to throwing hot coffee onto interns who failed to ensure his milk was steamed properly, O’Maddow egregiously misbehaved since the day he stepped onto set at Sox News studios ten years ago.

What is more, the network’s directors approved massive payouts over the years—in the neighborhood of $35 million total—in order to settle the many lawsuits threatened by those whom O’Maddow assaulted, insulted, harassed, or otherwise abused. O’Maddow was well-connected with the Sox board, all of whom he had introduced to the CEO and advocated for when they joined the board. Of the seven directors of Sox, two were wealthy former fraternity brothers of O’Maddow; one was an alumnus of his high school who graduated a few years after him; one was a professor to whom the Sox director stipend of $50,000 is the difference between having to keep driving his old Prius in perpetuity and getting to purchase a stylish new minivan instead; one was Dean David Brennen to whose law school O’Maddow had promised a very large gift; one was O’Maddow’s second cousin whose college tuition had been paid by O’Maddow but was now financially independent; and one was O’Maddow’s ex-partner who still received large alimony payments. These settlements were protected by ironclad confidentiality clauses, and as a result of the efforts of Sox, its public relations staff, and its lawyers, the public was unaware of what was going on. Sox wanted to keep it that way, because throughout this ten-year period it had fought numerous proxy fights seeking to maintain its current corporate form and fend off would-be acquirers of the company. Most recently, the company sent proxies to its shareholders for the 2017 annual meeting, but of course said nothing about the O’Maddow allegations or settlements.

It turns out that this whole effort was also advised and approved by the law firm of Dewey Cheatem & Howe, LLP (“DCH”), whose motto is, “You got problems? We fix ‘em without anyone knowing.” DCH has been sued many times by unhappy clients, landlords, employees, delivery-people, caterers, interns, etc., etc., and has been frequently investigated by regulators. Working alongside the equally disreputable investment bank, Gringotts Financial LLC, the law firm produced hundreds of pages of analysis (with extensive footnotes, charts, etc.) asserting (a) that the settlement payments of $35 million were easily worth it in order to keep O’Maddow at Sox, and (b) that no U.S. securities laws or fiduciary duties would be breached by
the actions of Sox in paying off the various aggrieved parties and keeping the course of action completely under wraps. The lawyers also noted (accurately) that the Sox articles of incorporation provide that “all officers and directors of this corporation shall be protected from suit and liability based on alleged breaches of their fiduciary duties, as well as being indemnified for all expenses (including attorney’s fees) and liabilities, all to the fullest extent permitted by Delaware law, as it exists now or may come to exist in the future.”

As a result of the O’Maddow scandal’s becoming public, Sox stock dropped precipitously, losing more than a quarter of its value (from $40 at opening bell on March 7, 2017, the day that the story broke, to $28 on March 14, 2017, the day after O’Maddow was fired). Sox has taken significant efforts at damage control, culminating in the firing of O’Maddow and procuring the resignations of several top Sox officials.

Several Sox shareholders whose stock values have been damaged by this scandal have retained you.

Please consider the materials within the scope of this course, and answer the following questions: Whom, and under what theories, do you advise your clients to sue? Do you recommend taking any preliminary steps prior to the suit, and why or why not? What do you think of your clients’ chances of success? [My suggestion is that you use section headings and structure your answer as well as possible.] (90 minutes)
QUESTION 2

The largest shareholder of Sox is Elon Tusk; while he has never served as officer or director of Sox, he owns 30% of Sox’s outstanding stock. Tusk is disgusted by the turn of events described above, and he has decided that he wants to “cash out” from Sox as much as possible to focus his money and time on his various tech startups.

Based in part upon his lobbying, and in order to try to appease other angry shareholders, the board of Sox declares a massive dividend—nearly the largest it is allowed to make under governing Delaware law. The planned Sox dividend is so large that it will essentially stop any efforts on the part of the network to expand further; the board has admitted that this move will “narrow the company’s focus to its existing business and limit future expansion.”

Tusk also successfully pressures the board of Sox to enter into a contract to purchase technological consulting services—“at a great friends and family rate, I promise!”—from one of his start-up companies, a Delaware entity named CrowdNews LLC, which has developed several fancy technological means of collecting and promulgating “crowdsourced” news. The board agreed to the CrowdNews deal to help modernize what it perceives as Sox’s “old school” news operation.

Some news reports have suggested that CrowdNews has struggled to get clients, and that Tusk is actually just seeking to bolster the startup by garnering it a high-profile client (essentially getting free advertising). (Tusk says these are “fake news.”)

News reports have also noted that Tusk supposedly had the idea for the start-up while chit-chatting with some Sox employees at the Sox annual shareholder meeting a couple of years before about problems faced by bigger media companies like Sox and potential technological solutions to them.

Your clients are back in your office (which you’ve spruced up thanks in part to the previous round of fees you charged them). They like the idea of the dividend but hate the idea that Sox would be limiting its opportunities for future expansion. They also think Tusk’s actions “just can’t be right.” Because you did such a good job before, they want you to prepare another lawsuit, “against CrowdNews, Sox, the board, whoever—but definitely focus on that jerk Tusk!!”

Please consider the materials within the scope of this course, and answer the following questions: Whom, and under what theories, do you advise your clients to sue? Do you recommend taking any preliminary steps prior to the suit, and why or why not? What do you think of their chances for success? [Again I suggest using section headings for clarity and organization.] (30 minutes)
QUESTION 3

The way the O’Maddow story broke on March 7 was this.

Bright and early that morning, O’Maddow had unleashed yet another cloud of obscenities at an intern for some (perceived) offense. As the crushed intern left the set, the Sox “fixers” on hand for this sort of thing scurried behind. Senior Executive Producer Richelle Ricardo witnessed it yet again; and yet again, she was disgusted. Of course she understood why interns take the deal that is offered; it is rational to do so; she had advised interns who had confided in her that she thought they should do so. And yet she had had enough of this guy, and this corporation.

Ricardo got up, walked into her office and to her computer. She pressed “publish” on a Facebook post that she had drafted previously. It outlined O’Maddow’s horrific behavior and stated that it had long been covered up by the powers that be at Sox. It also linked to a shared folder that she had created that included a large number of relevant documents (with identifying information about the victims redacted).

Ricardo knew she would be fired for making this Facebook posting, but she felt great about her decision. She immediately called her therapist (with whom she had often discussed this plan). She told her therapist what had happened—that the whole plan had been carried out. Now it was only a matter of time.

After Ricardo hung up the phone, the therapist, Siggie Freud, went out for a coffee with one of her other therapist friends, Carlie Jung. She couldn’t help but describe to Jung what had just happened; although Freud was careful not to supply any names, Jung quickly put the pieces together as to which personality’s and which company’s actions were likely about to be exposed. And as it happens, Jung’s hobby was being a day trader on the stock market; she logged onto her online brokerage account and bought a large number of out-of-the-money put options on Sox—in other words, she placed a large bet that Sox’s stock price was about to drop significantly. The bet proved highly profitable, of course.

But Jung wasn’t the only one who was trading in those fateful moments. As part of their cover-up, Sox had hired an independent security firm, Silence the Whistles LLC, to keep tabs on certain executives about whom it had concerns—concerns, in specific, that they might blow the whistle on the O’Maddow problem. Ricardo had been the target of some of this monitoring, and in fact, a security officer with Silence the Whistles, named Officer Pitino, had listened in on Ricardo’s phone call with Freud. Pitino immediately notified his supervisors of what had happened; but he also at the same time pulled open his own brokerage app and also made a large purchase of put options amounting to a bet against Sox. He too profited handsomely.

Can anyone in the story above be prosecuted for inside trading? (30 minutes)
QUESTION 4

Despite Tusk’s efforts, the CrowdNews venture hasn’t gone as well as intended. The actual managing member of the LLC is yet another Delaware entity, Tusk Investments LLC, of which Tusk is the sole and managing member. Through Tusk Investments, Tusk is the majority owner of CrowdNews. Of course, given his charm, charisma, and omnipresence in the media, he is also unquestionably the “public face” of CrowdNews.

At this point, the situation is thus:

• As cash flow has dwindled, Tusk and the staff of CrowdNews (who, needless to say, are cowed by their celebrity boss and do whatever he tells them to) have become more desperate, and have taken the following actions:
  o In order to secure supplies and equipment for their business, they have promised vendors many payments that they know the company probably won’t, absent a miracle, be able to make (Tusk will himself sometimes take the lead by telling the vendors that “of course you know I’m good for it”);
  o They have cut corners on things like insurance, of which they now purchase only the legally required amount and no more, leaving them unable to pay for certain tort claims that they anticipate as a result of their rather lax and unsupervised business operations (e.g., defamation claims due to their “crowdsourced” news site being used to settle personal grudges);
  o They have regularly distributed to their investors (including Tusk) the maximum amounts permitted by law; Tusk has been unwilling to invest any more funds in the business even as, for instance, the likelihood of the tort claims mentioned above has become more pronounced due to certain changes in the company’s focus and operations.

• Tusk has also lost his cool repeatedly—in one particularly bad incident, he screamed and shoved one potential investor into the wall when that investor decided not to help fund CrowdNews. The investor has threatened to sue.

• Minority investors in the business feel that Tusk is at fault for the failure of the business and the loss of most of their capital due to his inattention to the business and his poor strategy choices. The investors have threatened to sue.

• Although there has been no vote of the other members (and unanimity is required for such a decision), Tusk has been negotiating for a sale of all of the assets of the firm. In fact he even struck a deal—and signed an agreement purportedly on behalf of CrowdNews—with a would-be purchaser of the company’s assets. When, after signing the contract, Tusk consulted with his lawyers and realized that he would need to convene a member vote in accordance with the LLC Operating Agreement, he confessed that to the buyer, and the buyer has threatened to sue for enforcement of the contract. (The other members do not in fact support the sale.)

Tusk’s attorneys have brought you in as a specialist in corporate law to discuss potential liability for their client. They are confident that anything done by Tusk will be protected by one or both of the layers of corporate “veil” that they have put in place. Do you share their confidence? What are the consequences of Tusk’s attempted sale of the company?

(30 minutes)