CORPORATIONS
Final Examination
DECEMBER 12, 2003; 3:30 P.M.
Professor Backer

FINAL EXAM INSTRUCTIONS: PLEASE READ CAREFULLY

This final examination consists of EIGHT (8) pages. Please be sure NOW that you have all of the pages.

Put your exam number on all of the exam books you will be submitting NOW. You do not need to put any other information on the exam books. Do not write your name on the examination or on any of the exam books.

All answers are to be written in the exam books. You may write or otherwise make notes on the examination. Do not use any scratch paper; use only the exam books for this purpose and turn in all exam books used in this manner with the exam books in which you have written you answers. Please write on every other line and leave the backs of the pages blank. Please write as legibly as possible; illegible answers will not receive credit.

This is a limited open book exam. You may have with you the following: (i) BAUMAN, WEISS, PALMITER, CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS (5th ed. Thomson/West, 2003); and (ii) JEFFREY D. BAUMAN, CORPORATIONS AND BUSINESS ASSOCIATIONS: STATUTES, RULES AND FORMS (Thomson/West, 2003 ed.), all of which may contain such handwritten notes as you are able to squeeze onto them. NO ADDITIONAL NOTES, OUTLINES, OR REFERENCES OF ANY KIND WILL BE ALLOWED. If you have any questions about what you may use during the examination, please ask. A violation of this restriction is a violation of the honor code.

The final examination consists of Six (6) essay questions. The suggested time to complete each question is as follows:

<table>
<thead>
<tr>
<th>Question</th>
<th>Time</th>
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<tr>
<td>1</td>
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<td>2</td>
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<td>6</td>
<td>30 minutes</td>
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Instructions on answering the essay questions are underlined and are found at the end of each question. Follow these instructions carefully and discuss the issues presented fully. BE SURE TO ANSWER ONLY THE QUESTION ASKED OF YOU.
Indicate your answer clearly in the exam books. YOU DO NOT HAVE TO ANSWER THE QUESTIONS IN ANY PARTICULAR ORDER, AS LONG AS YOU IDENTIFY THE QUESTION YOU ARE ANSWERING.

Plan and organize your answers before starting to write them out. If you begin to run out of time and have not finished an answer to a question, or otherwise do not have time to finish writing an answer, present the points you wish to make in outline form in order to obtain partial credit.

Please keep the following in mind as you write your answers. The most important thing you can remember is this: answer the question asked and only the question asked. A good rule to follow is to read the question before reading the facts presented. Do not discuss legal doctrines that are not pertinent to the questions asked; likewise long introductory paragraphs which are not directly responsive to the questions asked; likewise long introductory paragraphs which are not directly responsive to the questions asked will receive no credit. Points will be deducted for erroneous statements of law. Please be sure to apply the law to the facts of the question as presented. If you think additional facts are necessary for a complete answer, state those facts and the reasons you believe such additional facts are necessary. An answer containing only a statement of your conclusions will receive no credit. Where this may be helpful to support your arguments, refer to specific cases by name (complete names and citations are not required) and to the Constitution and statutes by number (‘bluebook’ form citations are not required).

You will have 3 hours to complete this exam. The SUGGESTED TIME ALLOTTED and RAW SCORE POINTS are indicated on the top of each question. You may leave the examination room at any time during the exam, however, you will not be permitted to take anything out with you.

I suggest that you budget your time according to the suggested time allotments and relative percentage value of each question. It is better to partially answer a question than to skip the question entirely.

When time is called, stop writing immediately, and put your exam books and all other exam books you have used inside the front cover of the exam book you have number “1”. You will then turn your exam and exam books in as directed. If you finish early, please follow the same procedure.

Your grade will be based on this final examination, subject to decreases for excess absences. I have enjoyed this fall semester with all of you. I look forward to seeing many of you again in other classes when we can have even more fun(!!). GOOD LUCK! I know all of you will do well.
ADDITIONAL INSTRUCTIONS FOR LL.M. STUDENTS:

1. LL.M. STUDENTS ARE GIVEN AN ADDITIONAL HOUR TO COMPLETE THE EXAM.

2. LL.M. STUDENTS MAY BRING IN ANY ADDITIONAL MATERIAL THEY DESIRE TO THE EXAM, INCLUDING TRANSLATING DICTIONARIES AND OTHER MATERIALS.
QUESTION 1
(suggested time 30 minutes; 30 points)

You are general counsel to Consolidated Byways (CB) a distribution company operating large warehouse facilities in Carlisle, Pennsylvania. CB is incorporated in Delaware. The company has assets of $500 million, liabilities of $300 million and generates about $70 million a year in gross revenues. Because of increases in fuel costs, labor costs and property taxes, CB’s revenues have declined steadily over the last 10 years. Since 9-11-2001, CB has posted small losses. This year CB anticipates a loss of about $3 million.

CB is a publicly traded company, 30% of whose shares are owned by Ginger Rogers and her husband, Fred Astaire. The other 70% of the outstanding shares are owned in small amounts by 10,000 people. The CB board of directors consists of Rogers, Astaire, the dean of the Dickinson Law School, and Elizabeth Taylor, a famous movie actress.

Ginger Rogers, who is also the company’s chief executive officer, is crazy for auto racing. Rogers calls you to tell you that CB intends to make a $1 million contribution to the Carlisle Race Car Hall of Fame (the “Hall of Fame”) to help it survive a financial crisis that threatens to force the Hall of Fame to close. The Board of directors has no objection to the gift, which it has made in smaller amounts in prior years. Ginger Rogers is a founding member of the Hall of Fame. Rogers and her husband, Fred Astaire, are the sole members of the Hall of Fame Board of directors. In addition, all of the cars exhibited by the Hall of Fame are owned by Ginger and Fred.

Rogers believes that there is nothing wrong with making this gift. She also suggested that CB could even seek shareholder approval of a program of gift giving to the Hall of Fame.

WRITE A MEMO TO ROGERS ANALYZING, IN DETAIL, (1) THE LEGALITY FOR THE GIFT AND (2) THE CONSEQUENCES OF SEEKING SHAREHOLDER APPROVAL OF THIS GIFT GIVING.
QUESTION 2
(suggested time 30 minutes; 30 points)

Ay, Bee, and Cee are eager to start a business selling translation services to be called Translators, Inc. They are thinking about organizing the enterprise as a Model Business Corporation Act business corporation. In order to start the business they will need about $1,000,000. To raise this money, they intend to seek a bank loan of $500,000, and to each contribute the remainder. Ay has no interest in running the business but wants a veto right over a list of what she considers to be fundamental transactions. She especially does not want Bee and Cee to divert corporate money to themselves through high salaries and to limit dividends. She is willing to contribute $300,000 to the corporation, but wants a guaranteed return of $30,000 a year before anything is paid to anyone else. She also wants to fully participate in the distribution of dividends along with Bee and Cee. Bee and Cee are willing to contribute $100,000 each.

Ay, Bee and Cee’s accountant has proposed the following:

1. Ay should contribute all $300,000 for 300 shares of 10% fully participating preferred stock, each share having a liquidation value of $1,000 and no voting rights.

2. Bee and Cee should contribute $10,000 in return for which each would receive 10 shares of common stock. Bee and Cee should also each purchase notes from the company (i.e. loan the company) $90,000 subordinated to the bank debt and payable in full after 5 years. The notes would bear interest at 10% a year, about three times as much as interest to be charged by the Bank for the $500,000 loan.

WRITE A MEMO TO THE SHAREHOLDERS DISCUSSING ANY ADVICE YOU WOULD HAVE WITH RESPECT TO THIS SUGGESTION AND PROPOSING ANY ALTERNATIVES.
QUESTION 3
(suggested time 30 minutes; 30 points)

Assume all of the facts from Question 2, above.

Assume further that Ay, Bee and Cee have decided to incorporate Translators, Inc. in a Model Business Corporation Act jurisdiction with the financial structure described in Question 2, above, and that Bee will serve as Translators CEO, and Cee will serve as Translator's CFO and Secretary. Ay, Bee and Cee are the only members of Translator's board of directors.

On Friday, Ay, Bee and Cee's lawyer submitted the articles of incorporation for filing with the Secretary of State. There would be no way to know if the articles will be accepted for filing, and the corporation formed, until Tuesday. On Saturday, Bee found the perfect office space for the new corporation. She figured that the corporation was going to be formed 'at any moment' and told the landlord that she was acting solely as an agent for Translators, Inc., an existing corporation, on whose behalf she would enter into a lease. The landlord had no reason to believe that he was dealing with anyone other than Translators, but he chose not to inquire further about the corporation. He did not ask for proof of the existence of the corporation or for a copy of a board resolution authorizing this transaction. However, prior to offering the lease, the landlord did insist on looking at the initial financial statements of Translators. Bee showed him the Translator's business plan with the anticipated initial financial statements. This satisfied the landlord who told Bee that even though the corporation appeared to have little equity investment, it was sound enough for his purposes. On Sunday, Bee executed the lease as Translator's CEO. On Tuesday, Bee finds out that the incorporation documents have been rejected by the Secretary of State for failure to include the appropriate fees. Translators is finally incorporated a week later.

Since incorporating the business, Ay, Bee and Cee have never held a board of directors meeting. Instead, periodically, Bee sends around a consent form that contains a resolution ratifying all of the actions taken by the officers. The consents are always signed by all of the directors.

Because they never had time, Ay has been using one of her accounts as the 'bank account' of the corporation. But this has proven to be a problem since only Ay has access to this account. Ay has promised to open a corporate account, but for the moment, all of Translators' money is in a separate account in Ay's name. Ay also feels really bad because, from time to time over the last several months, she has used money from the Translators account to make payments on her car loans (but only when her own funds were really really low). She has always replaced the funds used for this purpose. On the other hand,
Translators has maintained an insurance policy covering it for all losses incurred on account of injuries occurring on the leased premises. The insurance policy is in the amount of $400,000, but covers only tort claims.

Six months later, Translators has run into financial difficulties. It has not fully paid interest on any of the notes held by the shareholders. Instead, it pays what it can from time to time. It has not made a lease payment for four months.

Landlord wants her money. The corporation has no money to pay the rent.

**WRITE A MEMO DISCUSSING WHETHER AY, BEE OR CEE ARE LIABLE UNDER THE MODEL BUSINESS CORPORATION ACT.**
QUESTION 4
(suggested time 30 minutes; 30 points)

Oncidium ("O") is the CEO and Phalenopsis ("P") is the Secretary/Treasurer of Orchid Heaven, Inc. ("OHI"), a company incorporated under the Model Business Corporation Act. Each owns 5% of the outstanding shares of the company. The remaining shares are owned by 2000 other people unrelated to either O or P. Shares of OHI trade on the Pacific Stock Exchange and are subject to the federal securities laws. The Board of OHI consists of O, P, Mel Gypsum (a famous actor), Ostrey Osbourne (a famous singer), and Dolly Tartan (a Country Western star and theme park operator).

O has wanted to sell OHI for a long time. But neither P, nor the other members of the board have thought the idea to sell OHI was a good one. Instead, P, on instruction from the Board of directors, has been trying to find a company to acquire to expand OHI's product line.

Three weeks ago, P started negotiations for the acquisition of Daisy Dukes, Inc., a Model Business Corp. Act company selling plants to large home improvement store chains like "Home Depot" and "Howe's". Daisy Dukes shares are widely held and are traded on the American stock exchange. Daisy Dukes has had labor problems in the past, and faces lawsuits from time to time because it tends to be slow paying its creditors. In addition, Daisy Dukes is a party to several leases on unfavorable terms that P would as soon abandon. The costs of these leases is substantial. But the business of supplying annuals is growing quickly and Daisy Duke's reputation among retailers is better than most.

Because OHI has little cash, P would like to purchase Daisy by offering Daisy's shareholders OHI debentures in return for shares of Daisy Dukes stock. He wants you to answer the following questions before he proceeds:

1. WHAT IS THE BEST WAY TO STRUCTURE THE TRANSACTION TO MINIMIZE THE RISK OF LIABILITY OR LOSS TO OHI?

2. CAN THE TRANSACTION BE STRUCTURED TO ELIMINATE THE VOTING AND DISSENTERS RIGHTS OF OHI OR DAISY DUKES SHAREHOLDERS?

3. CAN O CALL A SPECIAL MEETING OF THE OHI SHAREHOLDERS TO ADOPT A RESOLUTION COMPPELLING THE OHI BOARD TO ABANDON THE PURCHASE OF DAISY DUKES?
QUESTION 5
(suggested time 30 minutes; 30 points)

Assume the same facts as in Question 4. In addition assume the following:

For purposes of this question only assume that Daisy Dukes and OHI are both incorporated in Delaware. Daisy Dukes' shares have been trading for between $20-30 per share. Prior to 2001, these shares had traded in the $50/share range, but have traded as low as $15/share. Many investors believe that the shares are grossly undervalued but the company has refused to commission an independent valuation analysis. The company's officers have been worried for some time that the company's long term viability is not good because it needs a lot of money to modernize equipment.

The Board of Daisy Dukes consists of the following members:

1. **Daddy Dukes**, the founder of the company. He serves as the Board Chair as well as the company CEO. Daddy Dukes is 70 years old and has been talking about retiring for some time. Daddy Dukes is the owner of the largest amount of outstanding Daisy Dukes shares – about 9.9% of outstanding shares.

2. **Marma Dukes**, Daddy Dukes' wife of 40 years and principal advisor. She has served as company Secretary in the past but currently only serves on the board. She is also 70 years old and would retire with her husband.

3. **Baby Dukes**, 50, is Daddy and Marma Dukes' only son. He stands to succeed Daddy Dukes as CEO but currently serves as company CFO and Secretary for which he earns $5 million a year.

4. **Hello Kitty**, a 45 year old teacher at the elementary school where Baby Dukes went to school many years ago. She earns $23,000 a year as a teacher and $100,000 for her services as a director.

5. **Bats Mauro**, 65, the CEO of Trashy World, a company selling mail order goods from around the world. Daddy Dukes and Bats Mauro have been involved in business dealings from time to time over the last 30 years. Bats Mauro has no interest in Daisy Dukes and is not an officer or employee.

6. **Omeeye Lord**, 36, runs Consulting World, a business consulting service. Since 2001, Consulting World has been under contract with Daisy Dukes to provide consulting services. Since 2001 Consulting World has received fees of about $75,000 for such services. The consulting contract runs through 2005 when the contract is up for renewal.
7. Lotta Luv, 25, a film actress. She has been highly successful in her career and is reputed to have a net worth in excess of $80 million. She has no connection with the company. She does serve on the board of directors of 20 large corporations.

On December 1, the Board of Directors of Daisy Dukes approved a merger agreement pursuant to which a wholly owned subsidiary of OHI would be merged into Daisy Dukes. At the effective time of the merger OHI’s shares in its subsidiary would become shares of the surviving corporation and all current Daisy Dukes shareholders would receive OHI debentures. The amount of debentures received will be equal to twice the value of each share of Daisy Dukes stock, based on a pre-merger announcement price of $25 per share. Thus for every share of Daisy Dukes share, the holder would receive a $50 face value debenture. The debentures would pay interest at a rate of 6% per year and would be subordinated to all of the other debt of OHI, so that in the event of insolvency, only the equity holders of OHI would be paid after debenture holders. OHI’s debentures have been rated ‘B’ (a score of ‘A’ being reserved for the ‘safest’ debentures, and ‘C’ for marginally investment grade dentures – the closer to an A rating, the lower the market expectation of interest rate). In addition, the merger agreement provides that Baby Dukes will be retained as the CEO of the new OHI subsidiary at an annual salary (with anticipated bonuses) of $20 million and that OHI intends to retain the present board.

At the 12 hour meeting at which the board considered the merger, the board members reviewed the merger agreement (which they had been able to review for a week before the meeting), and asked questions of Daisy Dukes’ general counsel. Daddy Dukes assured the board that the terms were fair. He expressed his belief that the stock market price accurately reflected the true value of the company’s shares, that he would be satisfied to receive the merger consideration in exchange for his 9.9% interest in the company and that the 6% interest rate appeared to be fair because it was higher than the interest Daddy was currently getting from his bank for his saving account. Lotta Luv objected to the terms of the merger. She noted that in a similar merger she had read about in the Wall Street Journal the week before, the acquiring company offered 8% interest on similar debentures, but issued by a company whose debentures were ‘A’ rated. She wants Daisy Dukes to hold out for 10% interest. She convinced only Hello Kitty. The final vote was 5 in favor and 2 (Lotta Luv and Hello Kitty) against.

It is now one week before the shareholders of Daisy Dukes are scheduled to vote on the merger. Ah Ha, a Daisy Dukes shareholder, believes that the transaction is unfair. Her own financial advisors did a rough calculation and determined that the merger consideration could possibly be deemed to be at the absolute lowest end of a range of fair price. Ah Ha consults you to see what liabilities, if any the board of directors may have in connection with the transaction. WRITE A MEMO TO AH HA ADVISING HER OF THE NATURE AND EXTENT OF ANY LIABILITIES OF THE BOARD.
QUESTION 6  
(suggested time 30 minutes; 30 points)

The Happy Owl Corp. is a Delaware corporation. The company has authorized, issued and outstanding 1,600 shares of common stock with a par value of $100/share. It has no other shares outstanding. All the shares were sold for $500 per share.

The company reports its financial results on a calendar year basis. It reported the following financial statement as of December 31, 2002.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
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<tbody>
<tr>
<td>Cash</td>
<td>Current Liabilities</td>
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<td></td>
<td>200,000</td>
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<tr>
<td>Other Current Assets</td>
<td>Long Term Liabilities</td>
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<td>3,135,000</td>
<td>2,650,000</td>
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<tr>
<td>Total C.A.</td>
<td>Total Liabilities</td>
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<td>3,335,000</td>
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<td>Net Fixed Assets</td>
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<td>4,565,000</td>
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<td>Total Assets</td>
<td>Total Liab. &amp; Equity</td>
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<tr>
<td>8,000,000</td>
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The company earned net profits of $160,000 for 2003.

Happy Owl has just announced an intention to declare a $1 Million dividend. Your client, Son Rai, a Happy Owl shareholder, does not think it is a good idea for Happy Owl to be making distributions of any kind at this time. She comes to see you to talk about this.

WRITE SON RAI A MEMO EXPLAINING FULLY THE ANSWER TO THE FOLLOWING QUESTIONS: (1) CAN HAPPY OWL PAY A DIVIDEND OF $1 MILLION TO ITS SHAREHOLDERS AT THIS TIME? (2) WHAT STEPS, IF ANY, COULD HAPPY OWL TAKE TO MAKE LAWFUL ANY DIVIDEND THAT OTHERWISE WOULD BE UNLAWFUL? (3) HOW WOULD YOUR ANSWER CHANGE IF HAPPY OWL WAS ORGANIZED UNDER THE MODEL BUSINESS CORPORATION ACT?