Widener University

School of Law,

Business Organizations

| Professor Strauss | Tuesday, December 16, 1997 2:00 - 5:00 pm |
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| Exam No | |
| You may bring in and use any writt | ten materials that you desire. |
| Some of the sub-questions you are asked to comprehensive than others, and consequen | olem is worth one-half of your composite exam grade. o address within each problem are more tly, may be weighed more heavily. I suggest you blem one and one-half of the exam on problem two. |
| If, in answering a question, you find those facts are and why it is necessary to as | d it necessary to assume any facts not given, state what ssume them. |
| Answer <u>all</u> questions in the blue bo separate blue book. | oks. Begin your analysis of each problem in a |
| Please double space in the blue boo | k and WRITE LEGIBLY. |
| Remember organization and clear a | nalysis count. |
| Good luck! | |
| | |

Problem 1 (90 minutes, 50%)

Facts

Herbert Marcuse and Ernesto Guevara founded and incorporated Southern Air, in the state of East Carolina in 1947. Herbert and Ernesto each owned one-half or 50 shares of what became a very successful charter airline business. Shares were not classified. When both men died within six weeks of each other in January and February of 1987, they bequeathed their stock to their respective family members. Herbert gave 25 shares of stock to his wife, Betty, 10 shares to his brother, Rene, and 5 shares to each of his three children, Pierre, Margarite and Caroline. Ernesto left 10 shares to each of his five children, Isabel, Fidel, Evita, Raul and Ximena. From 1987 on each family annually elected three members to the six member Board of Directors. The Marcuse's have elected Betty, Rene and Caroline, and the Guevara's have elected Isabel, Evita and Raul. Starting in June of 1987 the Board of Directors appointed Rene to be President, a job he has continued to hold to this day. The Board at the time of Rene's initial appointment passed a resolution giving him the power to make "all major management decisions." Later in 1987 Rene entered into two contracts with Evita. First, without seeking approval by the Board of Directors, he, on behalf of Southern Air, signed a contract with her appointing her Chief of Operations. The contract stated that "in the absence of gross abuse of power Evita is appointed for a term of life at an annual salary to be set by a minimum affirmative vote of four members of the Board of Directors of Southern Air, but not to be less than \$50,000." There were no other terms to the contract. The board has voted each year to set her salary. Second, as a result of Evita's insistence, she and Rene also agreed to enter into a personal contract stating that "Rene in his capacity as a shareholder of Southern Air is to make every effort to continue Evita in her position as Chief of Operations."

East Carolina has adopted the Revised Model Business Corporation Act. In addition to including fairly standard provisions, Southern Air's Articles of Incorporation do not contain a statement that it is a statutory close corporation, and they are silent as to issues involving removal of directors, cumulative voting and notice and quorum requirements. The Articles of Incorporation identify 100 shares as authorized and contain the following provision which in relevant part states:

- A "Bona Fide Offeror" is defined for purpose of this provision as an individual who makes an offer to a shareholder of Southern Air for some or all of his or her stock in Southern Air as evidenced by a writing accompanied by a check to be held in escrow pending the acceptance of said offer . . .
 - D No stockholder shall sell his or her stock in the corporation except to a Bona Fide Offeror and without first offering to sell the same to the remaining stockholders substantially in proportion to the stock already owned by them

at a price per share equal to the offer of the price per share made by the Bona Fide Offeror. A reference to this provision of the Articles of Incorporation shall appear on each stock certificate issued by Southern Air.

For several years relations between the Marcuse and Guevara families were amicable. That ended in April of 1997 when Pierre Marcuse, who lived in Hawaii, and who had very little contact with the rest of the Marcuse family, decided to sell his shares in Southern Air. Following negotiations with Pierre, on April 10th Bill Gable made an offer for the shares in writing and wrote out a check to Pierre for \$100,000 which Bill gave to an Hawaiian escrow agent to be placed in escrow in Hawaii. Pierre then sent a certified letter to all of the other Southern Air shareholders offering to sell his shares to them "in accordance with Section 23 D of the Southern Air Articles of Incorporation." After informally meeting on April 22nd to discuss the matter, all of the remaining shareholders from both families said that they would not purchase Pierre's shares, allowing him instead to sell them to Bill Gable. Following the meeting, and without telling any of the members of the Marcuse family, Evita flew out to Hawaii, arrived at Pierre's home, and explained that she was the only shareholder who wished to buy his shares. She presented him with a bank check for \$100,000, and Pierre gave her his share certificates.

When Rene and the other members of the Marcuse family learned of this from their brother Pierre, they felt betrayed and concluded that the Guevara family was making a "cynical play to destroy our family's interest in this airline." Rene, Betty and Caroline all met secretly and hatched a plan to "get their company back." They decided that Rene would put the plan into action by calling a Board of Directors and Shareholders meeting for the following Sunday, May 4th, at 9:00 a.m. Knowing that Isabel would be away for the weekend and that Raul, a devout Christian would not miss Sunday morning religious services, Rene waited until 5:00 p.m. on Friday night, the 2nd of May, and left messages on the telephone answering machines of Isabel, Raul and Evita informing them that there would be a 9:00 a.m. Sunday Board of Directors and Shareholders meeting "to discuss something that had come up." The three Marcuse family Board members and Margarite all attended the Sunday meeting. As they hoped and expected of the Guevara clan only Evita showed up. At the meeting the three Marcuse family board members first voted to fire Evita from her position as Chief of Operations, and then all of the Marcuse's attending voted to fire her from her position as a Director. The three board members next voted to fill her position with Margarite.

Ouestions

Answer the following questions in order:

1. How would you have advised the Marcuse family members in advance of the April 22nd meeting about the merits of exercising the Right of First Refusal? Did Rene and the other members of the Marcuse family misjudge the effect that the substitution of Evita for Bill Gable would have on their ability to share control of Southern Air? Explain why you believe they either did or did not misjudge and upon what assumptions your answer is based.

- 2. Is Evita likely to prevail in a claim challenging the legality of her dismissal from her job as Chief of Operations? Is she likely to prevail in a claim challenging the legality of her dismissal from the Board of Directors?
- 3. Would the Marcuse family be likely to prevail in a legal claim to declare Pierre's stock sale to Evita null and void? Which family, if either, is likely to gain long term control of the Board of Directors, and upon what does this depend?

Problem 2 (90 minutes, 50%)

Question 1

"There is an intellectual inconsistency between the decision in <u>Theodora Holding Corp. v. Henderson</u>, 257 A.2d 398 (Del Ch. 1969) reflecting the modern approach of allowing directors to largely define the extent to which the corporation can pursue societal goals different from the financial interests of shareholders and the decision in <u>State Ex Rel. Pillsbury v. Honeywell, Inc.</u> 291 Minn. 322, 191 N.W. 2d 406 (1971) which does not allow shareholders to do the same." Do you agree or disagree? Why?

Question 2

"Despite management by the Board of Directors some powers in large publicly held corporations are in theory reserved for shareholders, but the truth is that these powers are either meaningless or can be easily circumvented." Identify which specific powers "in theory" belong to the shareholders, and in each case whether it is true that the power is meaningless or can be easily circumvented.

Question 3

Keepers Corp is a wholly owned subsidiary of Xron Corp. Keepers Corp is the general partner in a limited partnership called Enron. Prime Corp, Delta Corp, Kinjo Corp, and Isis Corp are all limited partners in Enron. Isis Corp is a wholly owned subsidiary of Branson Corp. Kelly Mobutu is the sole shareholder and only director of Branson Corp and the only director of Isis Corp. Creatively apply what you have learned in Business Organizations to discuss the nature of the conceivable circumstances under which a resourceful attorney might be able to hold Kelly personally liable for the legal liabilities of Enron. For each circumstance explain exactly what would have to be established to hold Kelly personally liable, and the conceptual problems with applying the law to such novel circumstances.

Question 4

Genflab Inc. has twenty-five shareholders all of whom reside in Delaware. Its principal place of business is in Delaware, its directors reside in Delaware, and ninety percent of its sales are to Delaware residents. Genflab Inc. is incorporated in the fictional Caribbean Island of

Gamba. Gamba's Business Corporation Law provides in relevant part that, "Notwithstanding anything in the articles of incorporation or bylaws to the contrary no directors of any Gamban corporation may be held liable in a stockholder derivative suit or otherwise for a breach of a fiduciary duty to shareholders including but not limited to the duty of loyalty." It also provides that "No director of any Gamban corporation shall have any personal liability whatsoever to any shareholders, employees or third parties with whom their corporation may deal."

Answer the following questions in order:

- A) If a derivative claim for a breach of duty of loyalty was brought in the Delaware Chancery Court 1) would the Court likely uphold the Gamban law? 2) In your opinion as a matter of public policy should the Court uphold the Gamban law?
- B) In a claim for negligence brought against several directors in the Delaware Superior Court by a Delaware customer who was injured in her shower by a Genflab product 1) would the Court uphold the Gamban law? 2) In your opinion as a matter of public policy should the Court uphold the Gamban law?

Question 5

Do you believe that from a policy point of view <u>Graham v. Allis-Chalmers</u> <u>Manufacturing Co.</u> 41 Del.Ch. 78, 188 A.2d 125 (1963) was rightly decided, and is it good law in Delaware today?

Which of the following was not a factor in encouraging the development of the corporate form of organization?

- A. The need to allow for many investors to aggregate their resources toward a common end.
- B. The need to limit the liability of managers of business entities.
- C. The need for ownership interests to be easily tradeable.
- D. All of the above were factors in encouraging the development of the corporate form of organization.

Which of the following is the most correct statement of the standard in Delaware that the Chancery court uses for reviewing the adequacy of a challenged settlement in a shareholder derivative suit?

- A. The court gives the settlement of the parties the deference of the business judgment rule.
- B. The court applies its own business judgement to determine whether the settlement was reasonable.
- C. The court upholds the settlement unless it constituted an abuse of discretion by the settling shareholders.
- D. None of the above.

Which of the following is most correct? In a triangular merger:

- A. The target merges into the parent.
- B. The target cannot become merged with the parent.
- C. The subsidiary's shareholder(s) do(es) not get to vote on the merger.
- D. The parent's shareholders do not get to vote on the merger.

Which of the follow is most correct under the General Corporation Law of Delaware?

- A. Shareholders have a right to a NOBO list but not necessarily to a CEDE breakdown.
- B. Shareholders who can demonstrate a proper purpose have a right CEDE breakdown but not necessarily to a NOBO list.
- C. Shareholders who can demonstrate a proper purpose have a right to a NOBO list and to a CEDE breakdown.
- D. Shareholders who can demonstrate a proper purpose have a right to a NOBO list, but not to a CEDE breakdown.