MONTEREY COLLEGE OF LAW

BUSINESS ORGANIZATIONS

Final Examination

Spring 2016

Prof. M. Cohen

INSTRUCTIONS:

There are three (3) questions in this examination.

You will be given three (3) hours to complete the examination.

Faculty answer not available.

1. Half Moon Bay Beanery's public stock offering on the New York Stock Exchange exceeded every market analyst's expectations. Within two weeks of the coffee company's initial public offering, thirty million investors had purchased its securities, which now traded at approximately $40 per share, yielding a market capitalization of $1.2 Billion. Yet the company's founder, chairman of the board and chief executive officer, Bonita Bonaventura, a retired horticultural professor, felt anxious.

   The company's sole, entire business model centered on her patent-pending hybrid coffee bean seed, invented to thrive in the ocean-facing, mineral rich western slope of the Santa Cruz mountains. The agricultural invention stood to bring a revolutionary new cash crop to California.

   To commercialize the revolutionary coffee seed, the company pursued a patent with the U.S. Patent and Trademark Office, a patent almost certain to be granted. The patent would give Half Moon Bay Beanery the exclusive right to grow and harvest coffee from the seed. Market analysts wrote glowing reviews of Half Moon Bay Beanery's potential, and investors reacted favorably, causing the stock to move steadily upward.

   Bonita, however, had just received a letter addressed to Half Moon Bay Beanery from a law firm representing her former university employer, asking the company to disclose the research and development timeline underlying the company's patent application. Bonita had developed the hybrid coffee bean while a tenured horticultural professor at the university. Her employment agreement with the university indicated that the college could assert ownership to inventions professors developed in the course of their employment using university labs and resources. While Bonita believed the question was a mixed bag with respect to her work, she suspected the university could make a claim to the invention, and if the university did make a claim, Half Moon Bay Beanery's stock would likely plummet instantly.

   After a few nights without sleep, Bonita's tired mind came up with an elegant solution. She determined she would just sell her Half Moon Bay Beanery stock now, locking in her fortune. Then whatever the fate of the patent, she would be set. And it would not be unusual, she thought to herself, for a company founder to lock in profits from the stock's initial public offering success. Unless and until the university made an objection or claim to the patent, the stock price would not be affected. She alone had received the inquiry from the university, and the company's next scheduled SEC quarterly report was months away.

   Just as Bonita dreamed up her profitable exit, another California dreamer, Drew Debauchery, a former university colleague, hatched his own prospective path to wealth. Drew knew Bonita had invented the hybrid coffee seed at the university, because he assisted her early research. If the

university had any rights to the coffee seed Bonita had developed, Drew surmised, the price of the Half Moon Bay Beanery stock would drop off a cliff, because the Company's entire business plan was based on its potential patent right to exclusively exploit the hybrid coffee seed.

Drew's contract with the university contained a nondisclosure provision requiring him to treat all information he learned through his employment as confidential, prohibiting Drew not only from disclosing any such information, but also prohibiting him from using the information for any purposes other than his work. It was simple enough, though, for Drew to inform the university of his research with Bonita, in hopes the university might claim ownership to the coffee seed invention, and that's just what Drew did.

Drew then planned to "short" trade the stock. A short trade is a securities transaction where Drew would place orders to buy the stock at a future value significantly lower than the current trading price of the stock. If the stock dropped to Drew's future "short" price, the broker would pay Drew the difference in value. If on the other hand the stock price went up, Drew would have to cover the difference. Under federal and state securities regulations, "short" trades are considered security sales fully subject to the laws governing stock purchases and sales.

Drew invited his broker to the Cal-Stanford football game to discuss Drew's Half Moon Bay Beanery stock "short" trade proposal. Sitting one chair behind them, Dora, a third grader attending the game with her mother, wondered what "shorting" stock meant. So she asked her mom, a Palo Alto investment banker, on their way home. "That's a strange question from someone in elementary school," Dora's mother commented, just before she proceeded to ask Dora to tell her everything Dora had overheard. "Lucky day for us," Dora's mom smiled to her daughter in the back seat, making the turn into their Los Gatos driveway.

a. What legal advice would you give to Bonita regarding her plan to sell her Half Moon Bay Beanery stock?

b. What legal advice would you give Drew regarding his plan to "short" trade the Half Moon Bay Beanery stock?

c. What advice would you give Dora's Mother about using the information Dora overheard to trade in the Half Moon Bay Beanery stock?

1) (28)

======== **Start of Answer #1 (1819 words)** ========

a. Bonita (10)

good analysis but central q = 16b5 Insider Trading Rule

Securities Fraud

Under rule 10b-5, Bonita may be held civilly liable for securities fraud, which occurs when a fraudulent statement or omission is made by a person in connection with the sale or purchase of a security, with intent to deceive or reckless disregard for the truth or falsity of the statement, causing loss. Each of these elements of fraud is discussed below.

Fraudulent: Bonita may be liable for making a false statement or omission of material facts, which are those that a shareholder would believe important in making a decision to buy or sell a security. Information about the university's request to disclose the research timeline and Bonita's employment agreement with the university is material, because if the university owns Bonita's invention the Beanery's entire business model will collapse and the business will be worth nothing. Any shareholder would believe this information is valuable in determining whether to buy or sell a stock currently valued at $40 that may instantly drop to $0. ✓

Bonita has made no affirmative statement so far, and can therefore only be held liable for an omission if she has a duty to disclose information. This disclosure duty can only be imposed by law, for example, the SEC quarterly report that the Beanery must file in a few months. Currently, as far as the public is aware, all statements (or lack thereof) made by Bonita indicate that the company is doing well, as reflected by the IPO success and reviews by market analysts. This public opinion is based primarily on the company's pending patent, likely to give the Beanery the exclusive right to use the hybrid coffee seed. Bonita would normally not have a duty to correct the misconception that the patent will mostly likely be awarded to her company, when in reality it could be

awarded to the university and destroy the value of the company, until the next SEC quarterly reporting period. However, Bonita knows that her lack of statement regarding the true status of the patent is false. She therefore may have a duty to correct the public's mistaken information about the success of the company and the status of her patent now knowing that failure to do so would constitute false information.

Made by a person: Only the person who has ultimate authority over the content and dissemination of the statement -- in this case Bonita -- may be held civilly liable for securities fraud. Bonita is the only person with control over the information about the university's request and her employment agreement who would owe any duty to shareholders, and since her potential omission of information is at issue here, this element is satisfied.

In connection with the purchase or sale of a security: Securities fraud does not allow for a plaintiff to recovery on the theory that he or she would have purchased or sold a security absent the fraudulent information -- such a purchase or sale must actually have been undertaken. Bonita's omission of material information about the university's potential claim to her coffee bean has caused the company to go through a hugely successful IPO resulting in 30 million investors and favorable market analyst reviews that have further increased the value of the stock. These 30 million investors have purchased securities in her company relying on information that Bonita will gain an exclusive patent, which information is fraudulent. Since such securities have been purchased in connection with Bonita's omission, this element is satisfied.

Intent: Concerned that the value of her company will drop dramatically if the patent is not awarded to her, Bonita has intentionally hatched a plan to deceive investors by failing to disclose material information to them while selling her own stock as the prices remain high. Intent to deceive satisfies the intent element of fraud.

Causing loss: Should Bonita's employment agreement interfere with her patent and cause the company's value to drop, immediate loss will be felt by all 30 million investors who bought shares in her company not knowing that this agreement existed. According to the fraud on the market theory, a plaintiff is presumed to have relied on information that is disseminated to the public at large. Market analyst expectations dependent on Bonita's omission of the university's potential claim to her invention have been distributed to the public, created a rebuttable presumption that loss caused by the company's plummeting value proximately caused loss to a plaintiff suing Bonita for fraud.

Conclusion: Bonita's best argument in her defense is that she has not made a statement and has not omitted anything from any required reporting. She is not required to disclose information about the university's request until the next filing period, and the argument that she has a duty to correct misinformation -- particularly when there are no facts showing that she has deliberately fed the market with information about the company's success to drive up stocks prices -- is not very strong. Should she be successful in finding that she did not fraudulently omit material information, Bonita will not be liable for fraud. I would advise Bonita not to go through with her plan.

Insider Trading

good

A better argument for Bonita's liability is insider trading. An insider is any director or officer of a corporation. in this case, Bonita is both, and therefore may not trade on any material nonpublic factual information about her company without disclosing it through channels that allow for widespread dissemination, or refraining from trading. As discussed above regarding Bonita's potential omission, information about Bonita's employment agreement is material and has not been disclosed by Bonita to anyone, let alone to the public at large. Because Bonita has not disclosed her insider information, she cannot trade on the information and will therefore be held liable for insider trading if she goes through with her plan to sell her Beanery stock now.

Short-swing trading

Rule 16b prevents any director, officer, or beneficial owner of more than 10% of a company's stock from trading within 6 months of purchasing the company's stock. Depending on when Bonita initially bought her stock in the Beanery, she may not be able to sell her shares if it has been less than 6 months. the corporation's shareholders could sue her to recover any profit made from this transaction.

good

Advice? Abstain or Disclose.

b. Drew (9)

Initially, because securities fraud does not contemplate aiding and abetting and only holds the person liable who had ultimate authority over the content and dissemination of the statement, Drew cannot be held liable for fraud even though his actions may implicate some of the other elements of 10b-5. However, he can be held civilly liable for insider trading under the outsider/misappropriation theory.

Outsider trading

Since Drew is not an officer or director of the Beanery, he is not an insider and the disclose or refrain rule discussed above does not apply. However, Drew may be liable for insider trading on an outside theory if it can be proven that he has misappropriated information, breaching a duty owed to the source of the information. Drew knew that Bonita invented the bean at the university -- and that the bean is therefore the university's invention -- because he assisted her in her research. Drew did not obtain this information illegally, and therefore did not misappropriate it in the sense of stealing it. However, Drew's contract with the university contains a nondisclosure provision requiring him to keep all information learned through his employment confidential and prohibiting him from using it for any purposes other than his work. The confidentiality agreement of course does not prevent Drew from disclosing his research to the

university, but it could be violated in connection with Drew's plan to short the Beanery stock. As long as he does not tell his broker the reason why he wants to go through with this trade, Drew will not be revealing confidential information in violation of his duty to the university. However, Dora's mom's reaction to her description of the conversation between Drew and his broker indicates that Drew did indeed reveal that he knew Bonita discovered the bean while at the university, causing the bean patent to belong to the university rather than to the Beanery. Furthermore, Drew's contract also prevents him from using information for any purpose other than his work. Since his work does not involve securities trading, he is violating his agreement simply by using information about his research with Bonita to short the Beanery's stock. *right*

Because the bean patent likely belongs to the university, Drew has violated his contract with the university not to disclose or use confidential information obtained during his employment, and has therefore breached a duty owed to the information's source. Drew will be held liable for insider trading on the outsider/misappropriation theory if he goes through with his plan to short the Beanery stock. I would advise his to refrain from this transaction.

Advice/Rule: Abstain or disclose to both Source and Owner!

Short-swing trading

Rule 16b prevents any director, officer, or beneficial owner of more than 10% of a company's stock from trading within 6 months of purchasing the company's stock. Depending on how much stock Drew is planning to buy in the Beanery, he could become a beneficial owner of more than 10%, and will therefore not be able to short the market by selling his shares for at least 6 months after his purchase. The corporation's shareholders could sue Drew to recover any profit made from this transaction.

c. Dora's mother *(9)*

Tippee liability

Dora's mother (M) could face derivative insider trading liability on a tippee theory. To be held liable, a plaintiff suing Dora must show that: (1) an insider personally benefited from disclosure of nonpublic material information to the tippee in breach of the insider's duty to the corporation; and (2) the tippee knew or should have known that the insider breached a duty. In this case, the insider would have to be Bonita, since Drew does not constitute a corporate insider. Bonita would not benefit from disclosing anything to M regarding Bonita's employment contract with the university, because Bonita's plan to withhold information and sell her stock would be destroyed if anyone else knew about it. M most likely knows Bonita is breaching a duty by failing to disclose material information and trading on it, but because the first element is not satisfied, M can likely trade on information from her daughter without being held liable.

Tippee Liability:
(1) Derivative of tipper;
(2) Tipper must benefit. Drew?

Short-swing trading

Rule 16b prevents any director, officer, or beneficial owner of more than 10% of a company's stock from trading within 6 months of purchasing the company's stock. Depending on how much stock M is planning to buy in the Beanery, she could become a beneficial owner of more than 10%, and will therefore not be able to short the market according to Drew's plan by selling her shares for at least 6 months after his purchase. The corporation's shareholders could sue M to recover any profit made from this transaction.

======== End of Answer #1 ========

2. Bonita Bonaventura had not founded Half Moon Bay Beanery and become its CEO and Chairman of the Board by throwing caution to the wind. Before actually selling any of her stock, Bonita Bonaventura consulted her sister, a Marin County non-practicing lawyer turned music agent, now representing an emerging jam-band called "Dirty Directors." Bonita could not make much sense of her sister's hurried half-baked response filled with broken sentences and acronyms. Bonita had another ace up her sleeve.

   Bonita knew that Half Moon Bay Beanery's hybrid California coffee bean was very sensitive to movement. The coffee beans, therefore, had to be picked by hand, or gathered by a special kind of mechanical harvester manufactured by only one small company, Monterey MotorCrops, a family owned business headquartered in the state's agricultural heartbeat, Monterey County.

   Bonita would use her Half Moon Bay Beanery stock shares as collateral for a loan to purchase Monterey MotorCrops. That way, whatever happened with the pending patent, Bonita would profit from sales of the only equipment that could be used to harvest California's new coffee crop.

   Eager to move from Aptos to the Cypress Point, the family who owned and operated Monterey MotorCrops Corporation agreed readily to Bonita's premium offer for the closely held company. The sale closed in less than thirty days. Life was looking up.

   Bonita then approached the university and proposed to sell Half Moon Bay Beanery's pending patent rights for cash. Advised by its attorneys that purchasing the pending patent was on balance superior to an uncertain legal dispute, the university agreed. Bonita saw no reason to advise the Half Moon Bay Beanery Board of Directors of the patent sale. After all, she was the company's chief executive officer and had every right to sell a company asset. Lawyers moved quickly and Bonita signed a letter of intent agreeing to close the all-cash deal selling the pending patent rights to the university.

   Unfortunately for Bonita, the most carefully laid plans often tempt fates.

   Just days before the scheduled pending patent sale to the university, the Half Moon Bay Beanery received service of a shareholder lawsuit seeking to enjoin the sale.

   Adding insult to injury, the same day Half Moon Bay Beanery received a demand from a shareholder insisting the Company file a lawsuit against Bonita. The Demand attached a draft Complaint alleging that Bonita breached duties to the Company when she purchased the Monterey MotorCrops Corporation.

a. Did Bonita breach her duties as a Half Moon Bay Beanery officer and director by purchasing the Monterey MotorCrops Corporation?

b. What process should Half Moon Bay Beanery follow to decide how to respond to the shareholder demand that the Company sue Bonita?

c. Does the shareholder lawsuit seeking to stop the sale of the pending patent to the university have any merit?

2) (32)

======== Start of Answer #2 (1347 words) ========

(10)

A. As CEO of the company Bonita owes the company the duty of care, loyalty and good faith. Directors of a company must discharge their duties in good faith, by a reasonable prudent person standard, in a manner that is in the best interest of the corporation. Directors duties are presumed to be valid and are evaluated under the business judgment rule. The business judgment applies when the director is disinterested and has made a decision, the decision is informed, and the director is making the decision in good faith. The presumption is rebuttable if one can show that there is an interest. The duty of lotyalty prohibits a director or officer from diverting a corporate opportunity to themselves at the expense of the company without first giving the company an opportunity to act. There are two test under the corporate opportunity doctrine. The first test is the delaware test which states that a corporate opportunity must be disclosed if it is in the same line of business and the company is financially able to acquire this test is not preferred because it can be easily manipulated by the fact that the company can sale assets in order to be financially able to acquire the corporate opportunity. The preferred test is the ALI test which states that all corporate opportunities must be disclosed to the board and there must be a rejection of the offer before a party can take advantage of the corporate opportunity. Under the first test Bonita would be found liable as a breach of loyalty because it was in the same line of business as her corporation considering that the bean seed was so sensititve that it required to be picked up by hand or gathered by a special kind of mechanical harvester manufacturerdd by only one small company, which is the same company that she was attempting to acquire. There are no facts to indicate that the corporation was not financially able to acquire Monterey MotorCrops (MM) for itself. As a director she has the duty of loyalty to the corporation and cannot take advantage of an opportunity to carve out her own fortune. Because she did not disclose the corporate opportunity to the board, and allow the board to reject the opportunity she would not have passed the ALI test and would have breached her duty of loyalty. He duty is to disclose all material facts and be candid with

excellent

her board of directors. Defenses to breach of duty of loyalty are: shareholder ratification, vote of majority of disinterested directors, and the k was fair to the company. Bonita will not have a defense since the board did not vote and there are no facts to show that the shareholders ratified, nor can it be said the the K was fair to the company because the acquiring assets would have made the HMBB a substantially great amount of profit.

(11)

B. Derivative suits are lawsuits that are brought on behalf of the company due to an officers/directos breach of fiduciary duty. The lawsuit is for the benefit of the company and not an individual shareholder. In order to bring a derivate suit there must be a valid claim, written a demand to file suit and the s/h must meet the contemporaneous ownership rule which states that in order for them to have standing they must have been owner of shares at the time the act occurred and must maintain ownership throughout the lawuist. After a valid claim has been established, in this case Bonita's breach of duty of loyalty for usurping a corporate opportunity, a shareholder must make a demand to the board to bring a lawuit. The demand requirement can been overlooked under the futility rule which states that if there is a lack of business judgment and an interested board then the shareholder can bring the suit by bypassing the demand requirement. Under the Universal demand that is used in CA, the demand requirement can not be overlooked even if the board is interested, the shareholders must make a written demand to the board and allow the board to decide to bring the suit or not to bring the suit. When there are issue in regards to interest the board can decide to make a Special Litigation Committe to decide whether or not to bring suit. The SLC has to have full auhtority, must have access to their independent advisors, must be disinterested and cannot defer to past boards business judgment. They must do their own work and decide whether it is int he best interest of the company to file suit. When the board has file a suit they can discontinue the suit if it is not in the best interest of the company but it will also be in the court's business discretion. The facts show that HMBB received a demand from a shareholder insisting the company file a lawsuit against Bonita. The demand attached a draft complaint alleging that Bonita breached duties to

excellent

the company when she purchased the MM corporation. Therefore, the shareholders have validly claimed a breach of fiduciaty duty of loyalty and have written a demand that is require. There are no facts to indicate that the board is interested considering that the board did not know about Bonita's purchase. The board received service of a shareholder lawsuit seeking to enjoin the sale, which shows that they did not have prior knowledge of Bonita's purchase. Because the board is not interested they would have to meet the requirements of the business judgment rule in deciding to bring a claim or not to bring a claim. The board is required to remain disinterested, must make an informed decision in good faith. A best practice to avoid any question regarding interest is to make an Special Litigation Committee that could decide for themselves whether to bring a claim. The committe will have to inform themselves of the transaction between Bonita and MM and her breach of loyalty. The committe will also have to look into a claim of corporate waste. Bonita has

C. (11)

When there is a sale in the normal course of business nothing is triggered. When there is a sale of substantially all of the assets of a corporation it triggers voting rights. The character of the business is changing substantially and therefore each party has a right to vote. And any shareholder against the sale can dissent triggering dissenter's rights which allows them appraisal rights. They must give the board warning on their intent to dissent. 10 days before the scheduled sale the Directors must informe the dissenting parties of the details of the meeting. Once the shareholder has dissented he/she must allow 120 days after the sale for the appraisal rights proceedings to begin. The sale of substantially all of the assets is measured by the Gimbel Test. The Gimbel test determines what substantially all of the assets means. The court will look at what is left of the company and decide if the company is still economically viable. It looks at the qualitative and quanititative factors to determine if the company can continue once the assets are sold. Under the Model Business Act so long as 25% of the company still remains the company can sell the assets. 25% is considered to still be viable. When there is a sale of stantially all of the assets it triggers 3 layers of protection: shareholder

excellent

vote, board of directors vote, and dissenters rights. The facts demonstrate that the only reason why HMBB is so profitable is due to the patent that it holds, without the patent the company would plummet instantly.The court will likely find that the patent constitutes substantially all of the assets which triggers shareholder voting rights. The facts show that Bonita saw no reason to advise the HMBB of directors of the patent sale, she felt that as CEO of the company she had every right to sell company assets. Because there was not voting the shareholders bringing suit have a valid claim to enjoin the sale of the patent.

excellent

======== End of Answer #2 ========

3. Half Moon Bay Beanery's litigation distractions caused its stock to hiccup. Calculating the Company's potential value, an iconic American corporate raider, Alabaster Smoothness, decided to seize the day.

   Smoothness publicized a Tender Offer to purchase up to 90% of Half Moon Bay Beanery's stock. The Tender Offer disclosed that Smoothness intended to file a short form merger to acquire the remaining ten percent if successful. The Tender Offer complied with the Williams Act in all salient respects, indicating that Smoothness would offer the same best price to all shareholders, hold the Tender Offer open for thirty days and accept all tenders with withdrawal rights until the tender closed.

   In a Wall Street Journal interview, Smoothness also disclosed that once he owned the Company, he planned to delist it from the New York Stock Exchange, sell its pending patent and dissolve the corporation.

   The Half Moon Bay Beanery stock began to swing in value wildly on the news. After a few days, upon the information settling into the marketplace, the volatility ended, and the stock leveled off at a stable price 35% below Alabaster's Tender Offer.

   Fortunately, Bonita Bonaventura had not consulted her sister in Marin County when she formed Half Moon Bay Beanery. A clever corporate lawyer in Los Angeles had advised her to adopt a "Poison Pill." She would notify Smoothness of the trigger, and he would go away.

   Surprisingly, Smoothness in response simply asked the Board to redeem the Poison Pill. The Board, however, refused.

   Smoothness did not budge. He had been through this war before, and believed if he did not flinch, the company would negotiate with him. He kept his Tender open.

   Bonita and the university then came up with a responsive plan. The university owned a publicly traded investment fund that managed commercial licensing revenues from inventions the university owned. The university proposed a stock-for-stock merger with Half Moon Bay Beanery. The university would merge its publicly traded investment fund stock into Half Moon Bay Beanery at an exchange ratio that would give the university fund a controlling shareholder interest in Half Moon Bay Beanery.

   The result would be the same publicly traded Half Moon Bay Beanery, but with a majority owner, the university investment fund, which would in turn refuse to tender its shares of Half Moon Bay Beanery stock to Alabaster Smoothness, effectively defeating the raid.

The Half Moon Bay Beanery and university investment fund Boards of Directors agreed to the deal and publicly announced their proposal and recommendation to the shareholders.

Still, Bonita had short term debt from her purchase of the Monterey MotorCrops Corporation, and she needed cash to meet her loan payments. She therefore convinced the Half Moon Bay Beanery board of directors to authorize a one-time dividend to all shareholders upon approval of the proposed merger with the university investment fund. Killing two birds with one stone, the dividend would serve the company's business interests by sweetening the proposed merger recommendation to the stockholders, and give Bonita cash to pay her loans. The Half Moon Bay Beanery had not yet made a single sale, because it had yet to grow and harvest a coffee crop yielding any revenue, but it had $1.2 Billion of market capital from its initial public offering on the New York Stock Exchange.

Alabaster Smoothness decided it was time to take off the gloves. He sued immediately to enjoin the proposed sale to the university investment fund, compel Half Moon Bay Beanery to redeem its Poison Pill and enjoin Half Moon Bay Beanery from declaring the dividend the Board authorized.

a. Will Alabaster Smoothness succeed in challenging the Half Moon Bay Beanery's decision refusing to redeem its Poison Pill?

b. Will Smoothness succeed in his effort to enjoin the Half Moon Bay Beanery's proposed stock-for-stock merger with the university investment fund?

c. Can Smoothness enjoin Half Moon Bay Beanery from declaring the dividend its Board of Directors authorized?

3) 33

======== **Start of Answer #3 (1182 words)** ========

A. Refusal to redeem the Poison Pill 11

Alabaster Smoothness (AS), an iconic corporate raider, made a hostile tender offer for the shares of HMBB's publicly traded stock. When a hostile tender offer is made, the board of directors will often take defensive measures to prevent the hostile takeover and preserve the corporation itself. The validity of these defensive measures are determined by the *Unocal* standard. This standard is essentially a heightened business judgment rule analysis. The reason why this heightened standard is applied is because the directors are self-interested in the sense that they want to preserve their positions as directors. Under the *Unocal* standard, a defensive measure is valid if: (1) there is a threat to corporate policy or effectiveness; and (2) the defensive measure is proportional in response to the threat posed.Additionally, the defensive measures must not be preclusive or coercive. Here, we are only analyzing whether the board's decision NOT to redeem the Poison Pill is valid; we are not analyzing the validity of the Poison Pill itself.

excellent

Here, the HMBB board will argue that AS's hostile tender offer presents a serious threat to HMBB's corporate policy and effectiveness because AS is a known corporate raider and has specifically expressed his intent to strip the corporation of its "crown jewel" and sole asset, the pending patent, and to dissolve the corporation. This clearly represents some kind of threat to corporate policy/effectiveness since AS has specifically announced his plan to ultimately dissolve the corporation; there is no greater threat to corporate existence. This threat is significant considering that AS's tender offer is 35% above the current market value. Thus, the question turns to whether refusing to redeem the Poison Pill was a proportional response to the treat posed. The HMBB board will argue that its decision not to redeem the Poison Pill was entirely proportional to the threat posed since the threat was extremely dire to the corporation. AS, however, will argue that failing to redeem the Poison Pill was not proportional, since his tender offer was so high above the market price that it would be irresponsible to the shareholders to

prevent the shareholders from receiving the inflated tender offer price.

Here, the Board will likely be successful in showing that its refusal to redeem the Poison Pill was proportional for two reasons. First, since the threat was to the existence of the corporation itself, virtually any measure the board took would have been proportional. More importantly, however, the Board will argue that since AS ultimately did not budge after the refusal, it was not a disproportionate to the threat posed; this tends to demonstrate that the refusal was not preclusive because it was still possible for AS to succeed in his tender offer.

exactly

B. Enjoining the merger with the university investment fund (11)

As noted above, actions taken by the Board in defending against a hostile takeover are generally governed by the *Unocal* standard. However, once it is apparent that the corporation is "up for sale" the duty of the board switches to that of an auctioneer with the duty to obtain the highest price for the shareholders. The moment when it is apparent that the company is up for sale is known as the "Revlon Moment".

excellent

***Unocal* Standard**

See rule above. Under the *Unocal* standard, the proposed merger with the university investment fund would likely be valid for much of the same reasons that the refusal to redeem the Poison Pill was valid. Specifically, since the threat posed was, essentially, existence of the corporation itself, any action would likely be proportionate. Like in the *Paramount* case, just because AS's offer may have provided more instant value to the shareholder, the measure that would result in existence of the corporation in a long-term basis would be justified. This merger agreement is not coercive, since the shareholders would ultimately have to approve the merger. Furthermore, it is not preclusive, since it is possible for AS to purchase the shares after the resulting merger.

AS's better argument is that HMBB experienced a "Revlon Moment" when he did not budge at the Board's refusal to redeem the Poison Pill.

Revlon Moment

Here, AS will argue that the company clearly became "up for sale" at the moment he kept his tender offer open after the Board refused to swallow the Poison Pill. This argument is persuasive because it was clear that AS was not concerned about the Board's defensive measures. However, the Board will argue that one corporate raider trying to strong-arm through a hostile tender offer does not make sale of the company inevitable. In fact, the Board will argue that because it was able to find a strategic partner who intended to help HMBB carry on its business, the company was not up for sale. More importantly, the university did not make a cash bid for the corporation. Ultimately, the court will agree that there was no Revlon Moment, since only one entity was interested in purchasing HMBB. Therefore, as stated above, the merger with the university investment fund would be a valid defensive measure under the *Unocal* standard.

outstanding analysis (In Paramount ct held stock-for-stock merger is not a Revlon change of control - for reasons expressed in the answer)

C. Enjoining the payment of dividends (11)

Typically, the decision to pay dividends is in the sole discretion of the Board of directors. If the board of directors can make any justifiable business argument for paying or not paying dividends, the court will typically uphold the decision. However, a corporation can only pay dividends from its actual profits. Here, HMBB has not turned a single profit, let alone a single sale. The only money HMBB would have to pay dividends is from its market capitalization. Therefore, HMBB would not lawfully be allowed to pay shareholder dividends.

exactly

The real question is whether AS has any standing to challenge the proposed dividend. Here, there are no facts stating that AS actually owns any shares of HMBB. If he were to acquire shares of HMBB, then he would have standing to challenge the proposed dividend payment. Likewise, if he were a creditor of HMBB, he would have standing to enjoin the proposed dividends. However, because there are no facts to indicate that AS is either a shareholder or creditor of HMBB, he would not have standing to enjoin the proposed dividend.

good

If AS does have standing to challenge the payment of dividends, and, for some reason, the court decides that the Board is allowed to make dividends from the market capitalization, AS may try to challenge the transaction as a violation of the duty of loyalty. Essentially, AS will argue that Bonita acted in self-interest in the transaction. However, even though Bonita is interested in the decision to pay dividends because of her personal debt, the board has a valid business reason for granting the dividends (to entice the shareholders to approve the merger, thus keeping the company from falling into the hands of a hostile corporate raider). Because the Board has some valid business reason to pay the dividends, it would be a valid decision. However, as stated above, the dividends will ultimately be invalid because there is no profit from which to pay them.

======== End of Answer #3 ========

END OF EXAM