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# READ CAREFULLY

Name (Please Print) \_\_\_\_\_

**DO NOT WRITE YOUR EXAMINATION NUMBER ON THIS PAGE.**

## BUSINESS ASSOCIATIONS

Final Examination

December 14, 1994

Professor Claxton

This examination is composed of six sections. The examination has an overall time limit of three hours: **YOU MUST NOT EXCEED THE OVERALL TIME LIMIT.** When you complete the examination, **PLEASE HAND IN YOUR ANSWERS AND THE COVER SHEET (PAGE A) THAT NOW IS IN FRONT OF YOU.** The cover sheet is to be placed in a separate box from the box in which you will place your answers. Your name should be printed on the cover sheet. Your examination number should appear only on your answers.

It is important that you follow these instructions carefully. TO REPEAT:

1. You are to return the cover sheet that now is before you.
2. Your name should be printed on the cover sheet (Page A).
3. The cover sheet is to be placed in a separate box from the box in which your answers will be placed.
4. DO put your examination number on your answers, but DO NOT put your examination number on the cover sheet.

I suggest that you quickly scan the entire examination before you begin writing.

Finally, please read the notice on Page A1. That notice was distributed to you on November 28. You must be in compliance with the terms of the notice.

## I

Mutt and Geoff formed a partnership to operate a grocery store. Five months after the store opened, Mutt informed the Crunchy Granola Company (which supplied the grocery store with various health food products) that he would not be personally liable for any additional sales that Crunchy Granola made to the grocery store. Soon thereafter, Geoff placed an additional order with Crunchy Granola for health food products to stock on the shelves of the grocery store. The order was filled. Crunchy Granola never received any payment for the products that were shipped to the grocery store in response to this order. The grocery store closed its doors, and Geoff went into personal bankruptcy. The Crunchy Granola Company eventually sued Mutt for payment. What result and why?

## II

The statement set forth below is an accurate (although very abbreviated) description of the position that owners of common stock occupy in the capital structure of a corporation. The statement is the introductory paragraph of a presentation that you, as a young attorney, have been asked to make to a group called the Mercer Novice Investors Club. The title of the presentation is "Equity Investment in the Corporate Arena." Your task is to complete a written draft of the presentation. After reading the statement, please proceed.

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The owners of common stock are the residual claimants to the earnings (and, in the case of a corporate dissolution, to the assets) of a corporation. As a consequence, of all the individuals and institutions that may invest money in a corporation in the form of equity or in the form of a loan, common shareholders are in the unique position of having the potential to enjoy the greatest financial gain *or* suffer the most severe financial loss.

## III

The directors of Mega-World, Inc., issued a series of press releases dealing with a major business development. The releases proved to be unduly pessimistic at best and seriously distorted at worst. When the full story of the major business development finally became known, the price of Mega-World stock promptly went through the roof. The stock posted the third-largest one-day gain in the history of the New York Stock Exchange.

Dan D. "Big Daddy" Warbucks is a self-made multi-millionaire who built his fortune trading in the stock market after being denied tenure at the law school of Mercer State University. Warbucks, acting in reliance on the pessimistic press releases, did not buy several thousand shares of Mega-World stock that strong evidence shows he otherwise would have purchased. Having failed to make the purchase, Warbucks lost the huge profit that he could have made by selling "his" shares after the value of Mega-World stock made its dramatic increase.

Warbucks brought suit against Mega-World, Inc. and its directors seeking recovery of the profits he had lost. He based his action on Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. What result and why?

#### IV

Overwood is a director of XYZ, Inc. Overwood also owns Whiteacre (and has owned it since 1980). In July of 1994, XYZ began seeking a large tract of land on which to build an industrial facility. In that month, XYZ also began seeking a different, smaller tract of land on which to locate its new corporate offices. In August, Overwood purchased a tract of land (Blackacre) that he knew was a picture-perfect location for the new XYZ offices. He promptly offered Blackacre to XYZ at a reasonable profit for himself. He also called the attention of the other members of XYZ's board to Whiteacre, and they concluded that Whiteacre would be a fine site for XYZ's proposed industrial facility. Overwood informed the board that he was willing to sell Whiteacre to XYZ. Due to the fact that Overwood had owned Whiteacre for many years, the profit that was built into the price for Whiteacre was quite large. The price itself was comparable to that of relatively similar tracts of land, however.

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The sales of Whiteacre and Blackacre to XYZ both were finalized on October 1, 1994. Several shareholders have brought a derivative action demanding that Overwood return the profits from both sales to XYZ, Inc. What result and why? (Consider all procedural and substantive issues.)

#### V

ABC, Inc. is engaged in various business activities with XYZ, Inc. XYZ is suffering from financial difficulties that apparently are the result of a combination of inexperienced management and simple bad luck. ABC is anxious to preserve XYZ as a viable business enterprise, and has decided to make a substantial loan to XYZ in an effort to help XYZ through its difficulties. Sally Sue Warbucks, the chief executive officer of ABC, is determined to protect ABC's interests by keeping XYZ's management team on a tight leash. In Sally Sue's words:

We are letting those boys have some money, and I guarantee that they are going to do what we tell them to do. Those fellows think they can put their pants on two legs at a time, and as a result they are falling all over themselves. XYZ owes money all over the southeastern United States, and we are going to make sure that all those creditors know that the first team is calling the shots now. They are not going to lose their money, because my company [ABC] is not about to lose *its* money.

You are a young associate with the law firm of Snide, Pride, and Hide, which represents ABC, Inc. The chairperson of the law firm's corporate and partnership department has asked you to prepare a memorandum discussing any basic legal issues that ABC should consider in its dealings with XYZ, Inc. and the XYZ management team.

## VI

Ivana Boesky teaches English to seniors at the Holy Order of Wayward Adolescents Catholic High School (the Fighting Inquisitors) in Runamok, Florida. She is devoted to her students, and gives a great deal of time to the school beyond her regular classroom responsibilities. Among other activities, she serves as the faculty adviser to the Temple Club (as in "My Body Is A Temple") and as the faculty adviser to the school's outstanding cheerleading squad. In the latter capacity she has become quite well-known throughout the community for the creativity displayed in the many cheers that she has developed over the years for the "Shake 'n Bakes," the traditional name for the cheerleading squad for the last three decades.\* A small sample of Ivana's cheers will provide some sense of her unique creative abilities and her devotion to the ideals of her school.

1. Rhythm Method, Rhythm Method,  
Play that song.  
Rhythm Method, Rhythm Method,  
Keep marching along.\*\*
2. Win one for the Pope!  
Win one for the Pope!  
He's no dope,  
Win one for the Pope!\*\*\*
3. Catholics win,  
Protestants lose.  
We got the touchdowns,  
They got the blues.

For several years Ivana has made small investments in stocks, pursuing an interest about which even her closest friends are unaware.\*\*\*\* In the summer of 1994, she made her single biggest purchase. When the stock of the Coca-Cola Company dropped to \$39.75 per share she acquired one-hundred (100) shares. Within four months after Ivana's purchase, Coca-Cola stock had jumped to a price of \$53.25 per share. At that point, Ivana suddenly confronted a rather severe short-term need for cash. Reluctantly, she sold the one-hundred shares of Coca-Cola stock that she had purchased only four months earlier.

Has Ivana run afoul of securities law restrictions on short-swing profits? Explain your answer thoroughly.

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\*As the reader might imagine, the prestige among one's peers that is derived from being able to say "I'm a Shake 'n Bake" is tremendous. The group has attracted even more attention since 1990 when, under pressure from proponents of gender equity, it accepted its first female Shakers 'n Bakers. That rather controversial step prompted the resignation of the 1990 captain of the cheerleading squad, Bubba "Tight Tuchus" Beauregard. For those readers who are interested in such matters (and even for those who are not), Bubba recently graduated from Florida State University and accepted a lucrative job as the personal trainer for Madonna. While at FSU, Bubba earned a small fortune marketing tapes and CDs of a smash-hit recording, *The Seminole Love Call*, made by one of the place-kickers on the FSU football team.

\*\*This cheer is a tribute to the school band, the Marching Candidates for Sainthood.

\*\*\*This cheer is in honor of the school's headmaster, Father Augustus (Big Augie) Pope. Really.

\*\*\*\*Had her friends paid a bit more attention to the contents of one of Ivana's favorite cheers (see page 4), they might have guessed that she had at least one interest in life beyond the Holy Order of Wayward Adolescents Catholic High School.

(continued)

Stock market up,  
Stock market down,  
We're gonna win 'em  
With a leap and a bound.

The bulls run wild,  
The bears stand tall.  
Whatever happens,  
We'll win 'em all.

Yeah!!