

BUSINESS ASSOCIATIONS
Professor John Orcutt
Fall Semester 2018

FINAL EXAM – IN CLASS
December 20, 2018

INSTRUCTIONS:

1. This is a closed-book examination. You may not bring any materials to the examination with the exception of ESL students who are allowed to bring and use a Home Language/English dictionary.
2. This is a 3-hour examination and is worth 280 points (or 70% of your final grade). The examination consists of eleven essay and short-answer questions.

Question	Possible Points	Suggested Time Allocation	Question	Possible Points	Suggested Time Allocation
Q1	9	5 minutes	Q7	9	5 minutes
Q2	26	15 minutes	Q8	35	20 minutes
Q3	26	15 minutes	Q9	35	20 minutes
Q4	9	5 minutes	Q10	43	25 minutes
Q5	35	20 minutes	Q11	18	10 minutes
Q6	35	20 minutes		TOTAL	160 minutes

I have written this exam to be a 2 hour and 40 minute exam (160 minutes). To provide some cushion in your taking of the exam, I am giving you an extra 20 minutes. Therefore, you will actually have 3 hours for the exam.

3. The grading of examinations is anonymous. So, you must write your examination number on the examination and your blue book. **YOU MAY NOT WRITE YOUR NAME ON ANYTHING – YOU MAY ONLY USE YOUR EXAM NUMBER.**
4. For those of you who are handwriting your exams, please write your answers in a blue book. The only answers that will be graded are the answers written into a blue book. While you are free to use scratch paper, answers written on scratch paper, or anything else other than a blue book, will not be read and will not be counted for any credit. Please write only on the front side of the pages in the blue book.
5. For those of you who are taking this exam on a laptop computer, you will be subject to the laptop exam rules that are provided to you by the Registrar. The above scratch paper rules also apply to laptop exams. I do not grade scratch paper.
6. Please remember that organization, persuasiveness, neatness and legibility all count in determining your grade on the essay answers. To improve the organization of an answer, you may wish to quickly outline the answer on a separate sheet of paper prior to writing your full answer in the blue book or on your laptop.
7. I have tried my best to write and proofread the exam so there are no distracting typos or other errors – but I may not have been totally successful. If you believe there is a typo or other error that makes it difficult to answer a particular question, please point out the error in your answer and explain any assumption you used to answer the question.

Good luck on the examination!

DO NOT TURN TO PAGE 2 UNTIL THE PROCTOR TELLS YOU TO BEGIN

BACKGROUND INFORMATION FOR QUESTIONS 1 – 4:

Questions 1 – 4 come from a shareholder derivative action on behalf of the Iron Bank of Bravos Inc. (“IBB”) against its directors. IBB, a Delaware corporation, is one of the United States’ largest banks. The case stems from IBB’s practice of cross selling.

Cross Selling. IBB offers a broad range of banking products, such as savings accounts, checking accounts, brokerage accounts, credits cards, mortgages, home equity loans, personal loans, business loans, and many other types of loans. In 2015, IBB implemented an aggressive strategy to sell more of its products to its existing customers (“cross selling”). Cross selling allowed IBB to generate additional profits from its existing customers. It also provided IBB valuable information about its customers’ behavior, which allowed IBB to make better decisions about credit, products, and pricing.

Cross selling is not a bad or unethical practice. In fact, IBB was quite proud of the strategy. IBB’s annual reports to investors touted IBB as the “king of the cross sell” and explained that IBB set a quota, the *Great Eight Initiative*, that “bankers were expected to sell eight products per household.” Bankers received bonuses for meeting the quota and could be disciplined or dismissed for not meeting it.

The Scandal. On November 27, 2017, a *Los Angeles Times* article publicly exposed that many IBB bankers were illicitly creating deposit accounts and credit card accounts for their customers without those customers’ knowledge or consent. Customers were charged fees on these additional accounts. The additional accounts could also negatively impact the customers’ credit ratings.

Following the article, federal banking regulators (the “Regulators”) investigated and found that from at least January 2016 hundreds of IBB bankers had illegally created millions of accounts without customers’ knowledge or consent. Following the investigation and its findings:

1. The Regulators imposed roughly \$300 million of fines and penalties on IBB, which IBB has paid.
2. The Regulators ordered IBB to fix numerous problems, and IBB has spent considerable resources to do that.
3. Affected customers filed a class action lawsuit against IBB which is ongoing.
4. The scandal hurt IBB’s reputation and its overall business results.

Derivative Suit. A number of IBB shareholders (“Plaintiffs”) brought a shareholder derivative action against IBB’s directors (“Defendants”) alleging the Defendants “knew or consciously disregarded that IBB employees were illicitly creating millions of deposit and credit card accounts for their customers, without those customers’ knowledge or consent.” Plaintiffs allege the Defendants knew about the fraudulent activity because, among other things, they were aware of:

1. Letters from employees complaining that the Great Eight Initiative created a high-pressure sales culture fostering fraudulent practices;
2. Complaints made through IBB’s internal “Ethics Line” about employees acting fraudulently to achieve sales incentives;
3. An employee filed a whistleblower lawsuit in early 2016 related to the creation of fake accounts; and

4. Several wrongful termination lawsuits filed as early as 2016 that included allegations of unethical sales practices.

Plaintiffs want Defendants to reimburse IBB for the damages they caused to the company.

Additional facts to consider:

- Plaintiffs did not make demand on IBB's board of directors before filing their shareholder derivative complaint.
- The composition of IBB's board of directors has not changed at all since the Great Eight Initiative was launched.
- IBB's certificate of incorporation includes an exculpatory clause per Delaware General Corporation Law section 102(b)(7).
- IBB's bylaws include an internal affairs forum selection clause (the "Forum Selection Clause"), which designates California as the exclusive forum for litigating lawsuits asserting internal corporate claims, including derivative actions.

Your assignment:

Question No. 1 (9 points possible: 5 minutes suggested)

Plaintiffs filed their derivative actions in Delaware state court. Defendants moved to dismiss the complaint for lack of subject matter jurisdiction. Defendants claimed a Delaware state court lacks jurisdiction over the dispute due to the Forum Selection Clause. Please analyze the validity of the Forum Selection Clause.

Question No. 2 (26 points possible: 15 minutes suggested)

Defendants contend Plaintiffs' complaint cannot be read to allege any fiduciary duty violation other than, at most, a breach of the directors' duty of due care. As such, they moved to dismiss the case at summary judgment arguing Plaintiffs' claims are barred by IBB's section 102(b)(7) clause. Please analyze the strength of Defendants' contention.

Question No. 3 (26 points possible: 15 minutes suggested)

Defendants also seek to dismiss Plaintiffs' suit because Plaintiffs failed to make demand on IBB's board before filing their derivative action. Please analyze the strength of Defendants' contention. In conducting your analysis, please explain whether you are using the *Grimes/Aronson* test or the *Rales* test, and why.

Question No. 4 (9 points possible: 5 minutes suggested)

For purposes of Question 4 only, please assume that Plaintiffs' complaint survives each of the motions to dismiss and continues. After months of discovery and depositions, Plaintiffs' counsel meets with the Defendants and their counsel to discuss a possible settlement of the lawsuit. Both sides are highly motivated to settle the dispute. Can the Plaintiffs and the Defendants agree to settle the dispute? Please explain. In providing your answer, please explain the rationale for the rule.

*** * * END OF IBB QUESTIONS * * ***

Question No. 5 (35 points possible: 20 minutes suggested)

The History Channel, Inc., a Delaware corporation, is looking for additional television shows to air. Walter, the CEO and a director of The History Channel, owns exclusive rights to broadcast the *You Are There* show. Walter purchased the rights in 1965, long before The History Channel existed. In 1965, Walter paid \$1,000,000 for the rights, which now have a fair market value of \$10,000,000. Walter has been negotiating with Janet, who is The History Channel's Head of Programming. According to long-established practice, Janet is authorized to purchase program broadcasting rights up to \$15,000,000 without obtaining prior board approval. Janet offers to pay Walter \$7,000,000 for the right to broadcast the *You Are There* show. Walter is ready to accept the offer.

Your assignment:

- (a) For purposes of Question 5(a) only, please assume the following additional facts. The full board of directors of The History Channel, Inc., is informed of the purchase (including Walter's role). Are they required to approve the deal under Delaware corporate law before completing the transaction? Should they approve the deal before completing the transaction? Please analyze and explain.
- (b) For purposes of Question 5(b) only, please assume the following additional facts. The History Channel, Inc. held a shareholder vote pursuant to DGCL section 144(a)(2) prior to purchasing the broadcast rights. The shareholders were fully informed of the conflict and the terms of the transaction. The results of the shareholder vote were:
- 52% of the outstanding shares voted to approve the transaction.
 - Included within that 52% were the shares held by Walter. Walter owns approximately 40% of The History Channel, Inc. and he voted all of his shares in favor of the transaction.

If a shareholder later sues the corporation over the transaction, what is the standard of review for the transaction? Does the business judgment rule apply? Please explain.

Question No. 6 (35 points possible: 20 minutes suggested)

Barack is a serial entrepreneur who has developed several successful start-up companies. Barack just finished the business plan for his latest venture and plans on forming a corporation soon. Prior to forming the corporation, Barack was presented with an opportunity to sign a 5-year lease (the "Lease") that Barack found enticing for his new venture. Barack told the Landlord he was signing the Lease on behalf of President Corp. ("President"), a corporation that was "to be formed," and the Lease reflected this fact. In addition, the Lease specifically stated Barack was not a party to, nor liable under, the Lease.

A few weeks after the Lease was executed, Barack formed President, which immediately moved its operations into the leased premises. President also paid the rent called for under the Lease. President's board of directors, however, never took any formal action regarding the Lease.

Roughly six months after the Lease was executed, Landlord decided it was not happy with the Lease. Commercial rental prices increased substantially in the last six months, so Landlord would like to get out of the Lease and re-lease the premises for a better price.

Your assignment: Is Landlord contractually bound to the Lease? Please explain.

Question No. 7 (9 points possible: 5 minutes suggested)

What is the rationale behind the business judgment rule? Please explain.

Question No. 8 (35 points possible: 20 minutes suggested)

Acme Corporation, a Delaware corporation, is an oilfield services company. Acme provides drilling services, pipeline construction, and project management in more than 50 countries throughout the world. The U.S. Securities and Exchange Commission (the "SEC") charged Acme with violating the Foreign Corrupt Practices Act (the "FCPA") from 2013 through 2016. The SEC charged Acme with making bribes and other improper payments to foreign officials in various countries to win business. Acme agreed to pay more than \$15 million to settle the SEC's charges. Acme's board of directors consists of nine directors. During its investigation, the SEC found six of Acme's directors secretly approved Acme's illegal activities. A group of shareholders brought a derivative action against the Six Directors.

Acme's board of directors formed a special litigation committee ("SLC") to investigate the derivative action and determine whether Acme should press the claims raised by plaintiffs, settle the case, or seek to terminate it. Acme's board granted the SLC full authority to decide these matters without the need for approval by the other members of the Acme board. The SLC consists of two independent directors who joined the board after the FCPA problem was resolved with the SEC. The SLC was provided with sufficient financial resources to hire counsel and other advisors and conduct a full investigation. The SLC thoroughly investigated the matter and concluded the derivative suit should not be maintained.

Your assignment: Does the SLC have the power to dismiss the derivative suit? Please explain. Would your answer change if Acme were a New York corporation and New York law applied? Please explain.

Question No. 9 (35 points possible: 20 minutes suggested)

Alex was the senior crew person on a ship (the “Ship”) operated by the Pacific Boat Shipping Co. (“Pacific”). The Ship experienced an emergency one evening. High winds and strong waves caused one of the Ship’s cargo containers to come loose. The container needed to be re-secured before it caused significant damage to the Ship. Alex needed assistance from the crew to secure the container. Alex went to Tom’s bunk to wake him up and have him help with the work. Tom refused to get out of bed, at which point Alex punched Tom in the head repeatedly and shouted, “Get up, you piece of garbage, and turn to.” Alex packed quite a punch. His blows caused Tom a broken jaw and a serious concussion.

Your assignment: Tom sued Pacific for personal injuries he suffered from Alex’s repeated punches. Please evaluate the strength of Tom’s case against Pacific.

Question No. 10 (43 points possible: 25 minutes suggested)

Abbi and Ilana are 50/50 partners in Soulstice Partners (“SP”). SP manufactures and sells concrete paving machines. Abbi is the owner of certain patents (the “Patents”) for the design and manufacturing of concrete paving machines. Both Abbi and Ilana made contributions to SP when they formed it. Ilana contributed the money for the venture as well as her services. Abbi contributed exclusive licenses for the Patents as well as her services. With an exclusive patent license, the patent owner (Abbi) provides the patent rights to a single licensee (SP). This means only SP has the right to make, use, or sell the inventions covered by the Patents. Even Abbi is barred from making, using, or selling the inventions covered by the Patents.

SP’s partnership agreement contained the following paragraph:

- 3.1 It is contemplated this partnership shall be permanent, and the same shall not be terminated or dissolved by either party except upon mutual approval of both parties. If, however, either party shall terminate or dissolve said relationship, the terminating party shall pay to the other party, as liquidated damages, a sum equal to four-times SP’s revenues in the last fiscal year before the dissolution. Said liquidated damages will be paid over ten years following the dissolution, payable in equal installments.

SP thrived for a few years, but ran into some difficulties when the economy slumped. Sales of the heavy machines dropped off significantly, and the partners could not agree on the direction the partnership should take going forward. Abbi is frustrated with the situation and wants to dissolve the partnership. She is willing to pay the liquidated damages set forth in the partnership agreement’s paragraph 3.1. She just wants to get the exclusive licenses back from SP so she can use her Patented inventions to run her own concrete paving machine business.

Your assignment: Abbi plans to write a letter to Ilana terminating the partnership and invoking the provisions of paragraph 3.1. Before doing so, Abbi has come to you for advice. Please advise Abbi.

Question No. 11 (18 points possible: 10 minutes suggested)

Bill and John formed a consulting firm as a two-person partnership. The consulting firm provides patent valuation services. When the partnership was formed, Bill contributed 70 percent of the capital, while John contributed 30 percent. Trusting their friendship and mutual respect would see them through any and all matters, the two never entered into a formal, written partnership agreement.

Due to numerous poor decisions by John, the partnership incurred approximately \$1 million in losses.

Your assignment: Please explain Bill's and John's responsibilities to each other for the \$1 million in losses. (Note: The question is not asking about Bill's and John's responsibilities to third-party creditors, only their responsibility to each other.)

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END OF EXAM

Have a wonderful semester break!!!