

FINAL EXAMINATION
CORPORATIONS
PROFESSOR LANI BADER
SPRING 2006

1. You have **three (3)** hours to complete this exam.
 2. This is a **closed book** exam. Students may not use any outside materials including notes, the casebook, the GCL or confer with each other during the exam.
 3. This examination consists of **three (3)** questions. Note that they are not of equal weight. Please write your response in the blue books provided. Please write clearly. Write on every other line and every other page to permit instructor comments.
 4. If you think that any question is ambiguous, or that some fact is missing which is necessary to answer the question, please make whatever assumption you think is necessary to clear up the ambiguity or to supply the fact that you believe is missing, tell what your assumption is, and continue to answer the question.
 5. Please answer the call of the question, but do not discuss abstract principles of law which do not directly relate to the issues raised by the question. I want short, not long, answers. Although the examination appears long you should have adequate time in which to do a good job.
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1. Write your exam number on your exam envelope. Put your correct class section and student exam# at the top of this page, each page of questions and each blue book. **Do not** use your name, student ID number or Social Security Number on any exam materials.
 2. At the conclusion of the exam, return all test materials, including blue books, scratch paper and this exam packet to the envelope and submit it to the proctor. **DO NOT** seal the envelope. Students who do not return all exam materials at the end of the exam may not be graded.

Good Luck!

QUESTION I

(25%)

The Balance Sheet of Preemptive Builders looks as follows:

PREEMPTIVE BUILDERS

A Corporation organized under the laws of the State of Magenta

Balance Sheet as of 12/31/05

ASSETS

Cash \$32,000

Land \$500,000

30 day Accounts receivable \$50,000

Note receivable (due 5/1/2009) \$50,000

Total Assets \$632,000

LIABILITIES

Accounts payable w/in 30 days \$50,000

SHARE HOLDER'S EQUITY

Legal Capital (100,000 common shares at \$20 par value) \$2,000,000

Deficit (\$1,418,000)

Total Liabilities and shareholder's equity \$632,000

Please answer the following questions with respect to the Preemptive Balance Sheet:

1. Is Preemptive solvent in the balance sheet sense?
2. Is Preemptive solvent in the Equitable sense? If you cannot tell, why not?
3. What is Preemptive's Net Worth?

4. What is the book value of the Preemptive shares?
5. Based on the Balance Sheet alone, can Preemptive declare a dividend if the State of Magenta follows the common dividend rules?
6. Can you tell whether or not Preemptive could declare a nimble dividend? If not, why not?
7. Could Preemptive declare a stock dividend? Why or why not?
8. Could Preemptive effect a stock split? If it could and if it wished to issue ten more shares for every outstanding share, what change (if any) would have to be made to the balance sheet to reflect that?
9. If Preemptive were incorporated in California, would any of your answers change?

QUESTION II

(25%)

Is there a Rule 10(b) 5 violation in any of the following scenarios? Explain why or why not:

1. Sara, a mail room clerk employed by Z Corporation, while at an office party, overhears a conversation between her boss and the CFO from which she infers that quarterly profits to be announced in a week will be significantly in excess of that which the market has predicted. The next day she buys 1,000 shares of stock; when the new profit number is announced one week later her shares rise 20%.
2. Mike, Sara's boyfriend, who is employed by a competitor corporation, overhears the same conversation that Sara hears. Without telling Sara, Mike buys 500 shares of stock; when the new profit number is announced one week later his shares (as with Sara's shares) rise 20%.
3. John goes to the ball game and overhears a conversation immediately behind him. He deduces from the tenor of the conversation that S's stock is in for a sudden rise. The minute the game is over; he calls his broker and buys S stock, and makes a substantial profit.
4. Edgar writes a financial gossip column called Heard on the street. He consistently purchases shares in various corporations; he then reports false good news with respect to those corporations whose stock he has purchased. When

- their stock rises on the basis of the false good news, Edgar sells the stock he has purchased on the rise, and makes a killing.
5. Tony, a psychiatrist, has a specialty practice consisting principally of treating stressed out CEOs and CFOs. While his clients are on the couch, he encourages them to talk about their corporations and current good and bad financial issues. He then, based on those conversations, purchases stock and makes a fair amount of money.
 6. Malcolm, the CFO of Magtech, calls Nephew in Ohio every month or so, and casually drops bits of good news about Magtech, knowing that Nephew will pick up on good news and purchase Magtech shares. Nephew does so and occasionally makes a fair amount of profit on his Magtech trades.
 7. Nephew tells Lori what Malcolm tells him, without disclosing the source of what he knows. Lori, believing that Nephew has connections, also trades, profitably.
 8. Reporter who attends a press conference at which a favorable development is announced and then immediately after the conference but before news appears on the ticker services, telephones his broker and places an order to purchase.
 9. A restaurant employee hangs up a diner's coat and sees in the pocket a memorandum describing a tender offer that is about to be made (but which has not yet been announced). She then purchases the stock of the target; when the offer is announced one week later the target's shares go up 30%.
 10. A restaurant employee hangs up a diner's coat and sees in the pocket a memorandum describing current quarter profits for Zyclone, and which says that they will be 25% more than expected. She then purchases Zyclone and makes a huge profit when the revised profits are announced.

QUESTION III

(50%)

Roger, a paralegal who lives and works in San Francisco, prepares the articles for Zytech, which is his personal startup. He then engages in the following transactions:

1. On March 1, before filing the articles, he orally on behalf of Zytech agrees to hire Alan as the CFO. Alan's tenure is to run for one year from April 1. Alan is Roger's roommate and is completely familiar with Roger's plans.

2. On March 15, on behalf of Zytech, he orally agrees to hire Bertram as the CEO. Bertram's tenure is to run for one year from April 1. Bertram agrees to become CEO because he believes that Zytech is a functioning business.
3. On April 15, Roger files the articles. He then causes Zytech to issue 1,000 shares to himself in consideration of his promotional services in forming Zytech. He also issues a second 1,000 shares to himself for a promissory note secured by the shares. Zytech then in the normal course of business issues 20,000 shares for cash to friends of Roger.
4. Move forward 1 year. While at a non-business related cocktail party, Roger (who has become the chairman of the Board), meets Alan, who is the CEO of Hitech, a competitor of Zytech. Alan tells Roger that Hitech has developed a radical new technology that will dramatically reduce production costs for Hitech's (and also Zytech's) product. Alan says that Hitech is willing to license one producer to use the technology, but one only. Roger, disenchanted with the direction that Zytech has taken, makes a deal with Alan to personally license the Hitech technology.
5. Assume Zytech has been successful. It is registered under 12 of the 34 Act. Roger is still Chairman of the board. Zytech shares are trading for \$22. On January 1, 2012, Roger who has been told that Zytech's earnings are going to be off prediction by 40% - sells 1,000 of his shares in a conventional market transaction for \$22. Roger's information is correct and when, 6 weeks later, the earnings figure is released, Zytech's shares go down to \$10. Roger immediately purchases 500 shares for \$10.

In each of the foregoing events, which of the actions by Roger create potential liability for Roger, or Zytech? What is the nature of the liability, if any, and if appropriate challenge was made to any of the actions, what would the result be?

END OF EXAM