

# University of Illinois College of Law Examination Cover Sheet

## **Business Associations II**

Professor Amitai Aviram

Spring Semester 2008

Number of Pages: 5 (including this page)

Time Allotted: Until 10am on the day following the day you received the exam

### **Exam Instructions**

1. **Permissible material:** This is an open book exam. You may use any materials you want, whether in hardcopy or electronic format.
2. **Anonymity:** The exams are graded anonymously. Do not put your name or anything else that may identify you (except for your student number) on the file that contains your answer to the exam.
3. **Receiving and submitting the exam:** You must personally pick up a copy of the exam from Angela Martin (Room 338) between 9-10am on the day of your choice among the following: April 30, May 1, 2, 5, or 6. You must submit the exam, by e-mail to Angela Martin ([aymartin@law.uiuc.edu](mailto:aymartin@law.uiuc.edu)), no later than 10am on the day following the day you received the exam.
4. **Confidentiality**
  - a. Once you receive this exam form, you are not allowed to discuss the exam with anyone until after the final day of the exam period for this semester (which may be later than the day of the exam).
  - b. Students who are enrolled in this course are not allowed to solicit or receive information on the exam if the source of this information (directly or indirectly) is a person who has seen the exam.
  - c. After the last day of the exam period for this semester, you are allowed to freely discuss the exam.
5. **Writing the exam**
  - a. The exam contains two questions. Answer one of them. I will grade only the question you answered first.
  - b. Cite relevant case and statutory authority.
  - c. When writing anything the source of which is neither your original thought nor part of the course material, you must give a complete citation of the source in a footnote.
  - d. Within the constraints of the length limit, answer all relevant issues that arise from the fact pattern, even if your conclusion on one of the issues is dispositive to other issues.
6. **Applicable law**
  - a. If a fact pattern or question specifies the applicable law, then assume that the relevant jurisdiction applies that law.
  - b. If neither the fact pattern nor the question specified the applicable law, then apply the law of each jurisdiction we addressed in the course.

7. **Length limit:** If you answer question 1 –
  - a. The total length of your answer should not exceed 1,000 words. Footnotes are not included in this count.
  - b. **For every 10 words in excess of the length limit (rounded up), one point will be taken off the exam's raw score.**
  - c. Footnotes may only contain citations and descriptions of the content of cases and statutes that are not in the course material.
  - d. This section does not apply to students answering question 2.
8. **“Fact” patterns are fiction:** The “facts” presented in the exam were constructed for an educational purpose, and were not intended to refer to or inform about any real person or event.

**Good Luck!**

## **Question 1**

**As Illini as Apple Pie:** Illini Book-Sellers (“IBS”) has operated a book store on the University of Illinois campus since the 1890s. Over the years it expanded, opening book stores in college towns all over the Midwest. However, it maintained its Illini roots, sponsoring U of I events and holding sales (with generous discounts) on days that the Illini football team played in bowl games (a policy that did not cost much, since the team rarely made it to bowl games).

**Going Public:** In the 1990s, IBS’s sole owner, B. Lou Orange (known to his friends as “Blue”), decided to take the company public. To appeal to investors, he incorporated IBS as a Delaware corporation prior to issuing shares to the public. To allow Blue to maintain control of IBS after offering shares to the public, Blue’s lawyers drafted IBS’s certificate of incorporation so that it had two classes of shares, A and B, with 1,000 authorized shares of each class. Both classes of shares had identical economic rights, but class A shares had 1 vote per share, while class B shares had 10 votes per share. The certificate of incorporation also authorized the BoD, without need for shareholder approval, to add terms regarding redemptions or conversions of class B shares, as long as no class B shares were outstanding at the time a new term was added.

Blue’s original intention was that class B shares would be issued to him and class A shares would be issued to the public. However, his investment banker advised him that at the price he wanted to offer shares to the public, potential investors would insist on equal voting rights. Blue therefore decided not to issue any B shares, though the section on B shares in IBS’s certificate of incorporation remained. He had IBS issue 250 A shares to him, and issue another 750 A shares to the public. Though he had only 25% of the votes, no other shareholder held more than 5% of the votes, and no one challenged Blue’s leadership. IBS’s BoD was composed of one director, and Blue was re-elected as the director every year.

**Trojan War:** The 2007-08 academic year started well for IBS and the Illini football team, which earned an appearance at the Rose Bowl. Sadly, the team was soundly defeated by the University of Southern California Trojans. Then matters got worse.

Blue received a call from the CEO of the Southern California University Press (“SCUP”), a California corporation. SCUP was interested in acquiring IBS as part of its strategy to expand its sales in Midwestern college campuses. It offered \$10,000 in cash per share.

The skies had come down crashing on Blue. He was horrified at the thought of taking orders from people who wear shorts in January, enjoy marine activities, and think that large flat corn fields are boring. He politely explained to SCUP’s CEO that IBS has Illinois values, which are at odds with “the way you do things in California” (he couldn’t get himself to call those things “values”).

Blue did not hear from SCUP for three months, and he thought that the Californians decided to go after another company. Then, one chilly April day, SCUP filed forms with the SEC that initiated a tender offer for 360 IBS shares, at a price of \$12,000 per share. From the forms it became clear that two months ago SCUP quietly purchased 150 IBS shares, so if the tender offer succeeded and SCUP acquired 360 additional shares, it would have 51% of the company's shares. The forms also stated that SCUP does not intend to execute a freeze-out merger if it gained control of IBS.

Blue hired lawyers and investment bankers, consulted with them and carefully considered their recommendations. He decided on several measures: (1) have IBS sue SCUP for violating the Williams Act, demanding \$20,000 in damages (the cost to IBS of implementing the "Trojan Horse" plan mentioned below, which IBS claims would not have been necessary if SCUP complied with the Williams Act); (2) Communicate to the shareholders that they should reject SCUP's offer because IBS should not be controlled by owners who have "foreign values"; (3) Execute a plan he named "Trojan Horse".

**Trojan Horse:** The "Trojan Horse" plan had two steps. First, the BoD would, pursuant to the authorization in the certificate of incorporation, add a conversion clause that stated that any class B share that is sold to another person would automatically and immediately convert into a class A share. Second, IBS would issue 850 class B shares and distribute them to shareholders as a special dividend (so that shareholders received one class B share for each class A share they owned). Shares owned by SCUP were to be excluded from receiving the dividend, and therefore the Trojan Horse plan was going to dilute the votes of the shares already held by SCUP (who currently had 150 of the 1,000 votes, but would have only 150 out of 9,500 votes once the class B shares were issued).

While many of IBS's shareholders were happy to receive the dividend, some perceived SCUP's offer as attractive and were concerned that the Trojan Horse would cause SCUP to withdraw its offer. They threatened to sue. In response, Blue agreed to modify the plan so that SCUP was not excluded (and therefore, the number of B shares to be issued was raised to 1,000). Blue also agreed to bring the plan to a shareholder vote.

**Endgame:** SCUP still did not like the Trojan Horse plan, and lobbied other IBS shareholders to withhold their votes in protest. At the shareholder meeting (which was convened in accordance with relevant law and IBS's bylaws), 400 votes were cast in favor of the plan, no votes were cast against it, and 600 votes were withheld. Blue, who was the chair of the meeting, declared that the plan was approved and would be implemented immediately.

SCUP announced that it was withdrawing its tender offer. Angela, an IBS shareholder, sued Blue claiming that the Trojan Horse plan was not authorized by the shareholders and that Blue exceeded his authority and breached his fiduciary duties in implementing it.

**Discuss IBS's suit against SCUP and Angela's suit against Blue.**

## Question 2

**From:** Ben I. Graham [mailto:Mr.BIG@work.com]

**Sent:** Tuesday, April 29, 2008 11:25 PM

**To:** Project Sandwich Mailing List

**Subject:** CONFIDENTIAL – Project Sandwich

You've been assigned to work with me on Project Sandwich. Our client is Charles Montgomery Burns ("Burns"), the wealthy owner of the Springfield Nuclear Power Plant and a frequent participant in the popular television show *The Simpsons*. Burns is interested in acquiring control of the **Panera Bread Company** ("Panera"), a corporation that is publicly traded on the NASDAQ (**NASDAQ:PNRA**). [Exam note: this is a real company, with branches in Champaign, IL] At this point Burns is interested in buying just enough shares to control the company, without cashing out the remaining shareholders.

Burns intends to offer cash and stock in the Springfield Nuclear Power Plant (a close corporation incorporated in Illinois) in return for Panera's shares [Exam note: the power plant company is fictitious; don't try looking for it in EDGAR]. He has enough spare cash to buy all of Panera's stock, but for tax reasons would prefer to use mostly borrowed money for the acquisition if possible. Burns has already communicated with Panera's management regarding a friendly acquisition, but they have rebuffed him. He is now prepared to release the hounds on them.

Investigate Panera (using only free public sources), find out what takeover defenses (if any) it has, how many shares are needed to control the company, who are the major shareholders, and any other information that relates to the ability to acquire the company.

Next, we need to write a memo to Burns, recommending how to acquire control in Panera, what are the legal and business risks, how Panera's management is likely to react and what we could do to counter that. Normally, I would write this memo, but I have a golfing emergency, so you are responsible for preparing the memo. Make sure to explain to Burns his various options in detail, and tie your analysis closely to Panera's particular circumstances – simply going through the options from your law school class notes won't do.

Thanks and good luck!

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### “Bare bones” Answer to Question 1 (not including research component)

#### I. IBS vs. SCUP

(a) SCUP violated the Williams Act by failing to file a Schedule 13D within 10 days of acquiring 5% of IBS.

(b) IBS has standing to sue SCUP for equitable remedies (such as recession of the purchases or divestiture of the shares acquired), but it does not have standing to sue for damages.

Therefore, IBS’s suit for damages will fail.

#### II. Angela vs. Blue

##### 1. Derivative Action

(a) IBS is not a party to this lawsuit (Angela sued Blue) and therefore this isn’t a derivative action.

(b) Does Angela have a direct cause of action against Blue? Under *Tooley*, suit is derivative if IBS suffers the alleged harm and would receive the benefit of recovery or other remedy. Under *Agostino*, question is whether given alleged harm and requested remedy, can plaintiff prevail without showing injury to the corporation? While not clear cut, under these tests the suit seems derivative because it alleges director entrenchment, and the harm is to the corporation; Angela did not have an individual right to receive \$12,000 for her shares; rather, IBS has a right that Blue will maximize its value, which Blue violates if he passes on an opportunity to maximize value in order to entrench himself.

(c) Demand futility: Under *Aronson*, demand requirement is excused if plaintiff shows reasonable doubt that either: (i) majority of the board is independent for the purpose of responding to the demand – here, the only board member, Blue, clearly has CoI in deciding to sue himself for breach of fiduciary duties; (ii) challenged transaction is protected by the BJR – Blue’s CoI in adopting a disproportionate takeover defense that protects his current control of IBS raises reasonable doubts regarding applicability of BJR. So, if Angela’s suit is derivative, demand would be excused.

##### 2. Did SHs approve Trojan Horse plan?

(a) Quorum: DGCL s216(1): by default, quorum consists of a majority of shares entitled to vote. Under *Berlin* (cited in *Licht*), shares withheld on a particular matter are still counted towards the quorum if they are present through proxy or in person. So, all 1,000 shares entitled to vote were present, even though 600 of them withheld their vote on Trojan Horse.

(b) Vote: Under DGCL s216(2), “the affirmative votes of the majority of shares present... shall be the act of the stockholders.” Under *Berlin* (cited in *Licht*), votes withheld are not part of voting power present. Therefore, the plan was approved by the affirmative vote of all voting power present.

(c) However, SHs are not authorized to run IBS or approve Trojan Horse; BoD is authorized to do this. SHs may ratify a faulty BoD decision, but while the plan was approved by shareholders, it was not ratified by them (see II.3.c below).

(d) SHs were not asked to approve an increase to the number of authorized A shares. Since all authorized A shares have already been issued, B shares that are issued cannot be converted into A shares, and the plan will fail.

### 3. Did the directors breach Fid Duties in implementing the Trojan Horse?

(a) Blue employs a “just say no” strategy. This does not violate his *Revlon* duties because IBS purports to have a long-term strategy and has not sought to sell itself or to break itself up (which would trigger *Revlon* “auctioneering” duties).

(b) Is Trojan Horse a takeover defense? Yes – SH owning 1 A share and 1 B share has 11 votes, but if he sells the shares to SCUP, B share turns into A share and combination has only 2 votes. Those who do not sell to SCUP will have 11 votes for the same combination of shares. This is a form of a voting plan known as a “tenure voting plan”.

(c) *Unocal*: Board must: (i) act in good faith: no evidence of lack of good faith or of CoI; (ii) act after reasonable investigation/deliberation: here, seems the deliberation and investigation were reasonable; (iii) defenses are proportionate to the threat posed: Unlike *Unocal*, here no threat of coercion through front-loading; though the BoD sees a threat to IBS’s “corporate culture” (considered a relevant interest in *Paramount*). The voting plan cannot be redeemed once launched, since the board is not authorized to add rules regarding redemption when B shares are outstanding. This seems to make the voting plan excessive to counter a non-coercive bid. The voting plan hinders any takeover, even ones from bidders with a compatible “culture”.

(d) Ratification: SHs approved Trojan Horse in what appears to be an informed vote (see II.2 above). However, under the *Fliegler* interpretation of DGCL s144(a)(2), votes of conflicted SHs are not considered and ratification requires “majority of the minority” votes. Excluding Blue’s and SCUP’s shares, this requires a majority of the 600 disinterested votes; Trojan horse only received 150, so no ratification.

(i) If ratification is nonetheless deemed valid, then by analogy to *Weinberger* (which was in a different context, of a friendly acquisition) BoP as to fairness shifts to the plaintiff, but court may still consider fairness. Here, it seems that the voting plan is unfair (because it is disproportional to the threat posed by SCUP, see II.3(b)(iii)) and therefore court will likely find that Blue breached his fiduciary duties.