

**University of Illinois College of Law
Examination Cover Sheet**

Business Associations II

Professor Amitai Aviram

Spring Semester 2009

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 four-digit exam ID 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 Becky Brouillard (Room 116) between 9-10am on the day of your choice among the following: May 6, 7, 8, 11, or 12. You must submit the exam, by e-mail to Becky Brouillard (roakley@illinois.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. Unless the exam question specifies otherwise, assume that the relevant jurisdiction applies Delaware law.
 - c. Cite relevant case and statutory authority.
 - 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. **Length limit:** If you answer question 1 –
 - a. The total length of your answer should not exceed 1,000 words.
 - 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. This section does not apply to students answering question 2.
7. **"Fact" patterns are fiction:** The "facts" presented in this exam were constructed for an educational purpose, and are not intended to refer to or inform about any real person or event.

Question 1

Digger Corp. (“Digger”) is a publicly-traded Delaware corporation. Digger has 120M authorized shares and 100M outstanding shares. 20M of Digger’s shares are owned by the notorious financier Ernie Badoff (“Badoff”). All other Digger shareholders own less than 5M shares each. Digger’s BoD consists of three directors: Malus Badoff (“Malus”), Badoff’s son; Mark Meek (“Meek”), a professor of law & finance; and Beth Bron (“Bron”), a mining engineer. Bron serves as the Chairperson of the BoD, and Malus serves as CEO. Meek and Bron are not affiliated with Badoff in any way other than being appointed by Badoff as directors in Digger.

The rise and fall (and rise and fall) of Digger: Digger is a mining company. In 1999, when the price of copper hit a 60-year low of about \$1,300/ton, Digger sold most of its other mining operations and used the money to buy copper mines at low prices. Digger’s timing was fortuitous: by 2006 copper was selling at about \$8,250/ton. But by early 2007 copper prices plummeted again, reaching around \$5,000/ton.

Digger’s BoD believed that the dip in price is temporary, and that this was an opportunity to acquire more copper mines at a low price. In March 2007 Digger took a two-year loan of \$2B, and used the money to buy additional mines.

Again Digger appeared to be perfect: by early 2008 copper was approaching \$9,000/ton. Digger’s BoD deliberated whether in March 2009, when the loan came due, they should sell some of the mines (at a hefty profit from the price they bought them) to pay the loan, or whether they should take advantage of the (then still) healthy credit market to roll over the loan (i.e., take a new loan to pay the old one back).

Neither option proved viable. By late 2008 a credit crunch and several bank failures scared away lenders. A global economic recession followed the credit crunch, and by early 2009 it was clear that demand for industrial commodities like copper would decline in the foreseeable future. In February 2009, a month before the loan was due, copper prices were around \$3,300/ton and copper mine prices correspondingly fetched very low prices. Digger had only \$500M in cash and in one month would have to pay \$2B. Its shares were trading at about \$22/share.

Digging out of a hole: After deliberating and consulting with experts, Digger’s BoD determined that it was not feasible to sell mines at current prices, and that Digger could not receive a loan for less than 20% annual interest, which was prohibitively expensive. Meek suggested that they raise the \$2B to repay the debt through a “rights issue”: an offer to the existing shareholders to buy newly issued shares. Under this plan Digger would offer each shareholder to buy for \$20 a new share for each share it already owns. If that shareholder refused, the new shares would be offered to other shareholders or third parties. Thus, Digger would issue 100M new shares and raise \$2B.

If all shareholders agreed to buy the new shares, then Digger will have raised \$2B, and there would be no change in the ownership of the company – each shareholder would have double the number of shares, but since the total number of shares has doubled too, that would amount to the same percentage of the company as before. However, if a shareholder refused to buy new shares and those shares were purchased by others, then the refusing shareholder will find his percentage ownership in the company cut by half (since he will have the same number of shares as before, but the total number of shares will double).

A board divided: Bron liked this idea, but Malus was strongly opposed to it. After a long discussion Malus disclosed his concern: Badoff, who was also suffering from the economic downturn, did not have any available cash to buy new shares in Digger. If Digger went ahead with its rights issue and Badoff was unable to purchase new shares, then his ownership of Digger would drop to 10%, and other shareholders might be able to form a coalition that would seize control of Digger.

Bron warned Malus that this was Badoff's problem, not Digger's, but Malus pointed out that the rights issue would require increasing the authorized shares to 200M, which would require a shareholder vote, and that Badoff would likely be able to vote down the proposal at the shareholder meeting.

Meek, who hated discord and liked to appease everyone, suggested that the board appoint him as a special committee to negotiate and sign on behalf of Digger a deal with Badoff that would allow the rights issue to proceed. Bron and Malus agreed and the board unanimously voted to create and authorize the committee.

After several days of intense negotiations, Meek (on behalf of Digger) and Badoff signed an agreement under which Badoff would sell to Digger a copper mine he owned for \$400M (which Badoff would use to buy the 20M shares offered to him in the rights issue). Also under the agreement, Badoff had the right, within three years of the sale, to buy back the mine for the same price of \$400M. Prior to signing the deal, Meek hired an investment banker who specialized in mining deals to advise him. The banker investigated Badoff's mine and determined that its fair market value was about \$400M.

Bron did not like the deal signed by Meek. She e-mailed Malus and Meek to convene a special board meeting that night, to discuss whether Digger was bound by the agreement. In a heated e-mail exchange between Malus and Bron (to which Meek was CC'd), Malus claimed that there was no need to meet that night since the deal was good for both sides, and that Bron simply had ill-will towards Badoff. In the last e-mail of the exchange, Malus advised Meek not to show up for the meeting (and said he would also not show up), since there was nothing to talk about and "Bron won't be chairperson – or even director – for long". Following this, Meek sent an e-mail to Bron saying: "I'm sorry, Beth, but I don't want to get myself involved in this fight so I won't show up tonight. I hope you and Malus patch things up."

Me, myself and I: Bron nonetheless convened a board meeting that evening. Malus and Meek did not show up. Furious, Bron formally proposed and voted on a board resolution to amend Digger’s bylaws and add the following clause: “In shareholder votes, each shareholder shall have one vote, regardless of the number of shares that shareholder owns.” The resolution passed by a vote of 1-0. Bron then concluded the meeting.

The following day, Bron wrote an e-mail that she sent to all of Digger’s shareholders. In it she described the events mentioned above, including her reservations about the Meek-Badoff deal and Malus’ implied threat that she would no longer be a director. She informed the shareholders of the bylaw amendment passed yesterday, which, “shifts our company from plutocratic governance to truly democratic governance, in which each shareholder has an equal vote, regardless of their wealth.” She concluded by saying that if shareholders agreed that she acted in their interest, they should re-elect her as director.

Shareholder Complains: After reading Bron’s e-mail, Gavin Goodwin (“Goodwin”), a Digger shareholder, sent an angry letter to Bron, Malus and Meek. Goodwin said that, based on Bron’s e-mail, Meek breached his fiduciary duties by giving “a sweet deal” to Badoff, and that the company should address this matter.

Tense Truce: In the next board meeting, Malus proposed a new bylaw amendment repealing the amendment passed by Bron. Meek again refused to get involved in the dispute between Bron and Malus, so Malus dropped the amendment proposal. Malus then proposed a date for a special shareholder meeting to increase the number of authorized shares to 200M in order to facilitate the rights issue. He also said he wanted to have the shareholders re-elect directors. Bron agreed as long as shareholders could choose between two slates of candidates – one proposed by her (including Bron herself and two other people), and the other proposed by Malus (including Malus, Meek and David Docile, a mining engineer unaffiliated with Badoff or Malus).

All three directors agreed, and the board arranged for a shareholder meeting to increase the number of authorized shares and re-elect directors. [For the purposes of the exam, you may assume (and do not need to discuss) that Digger followed all required procedures for convening the shareholder meeting.]

Meek then raised Goodwin’s complaint and asked for a board resolution that his behavior was faultless and Goodwin’s complaint is frivolous. Malus and Meek voted in favor, Bron abstained, and the resolution passed.

Endgame: At the shareholder meeting, shareholders overwhelmingly approved the increase in the number of authorized shares. Regarding the election of directors, 27M shares voted in favor of Malus’ slate of directors and 24M shares voted in favor of Bron’s slate of directors. However, if one counts the votes of shareholders rather than shares then 4,211 shareholders voted for Malus’ slate of directors and 62,848 shareholders voted for Bron’s slate of directors. Both Malus and Bron sued for a declaratory judgment that their slate of directors was elected. Meanwhile, Goodwin sued alleging that Meek breached his fiduciary duties by signing a one-sided deal that was good for Badoff but bad for Digger.

Discuss: (1) Which slate of directors was elected? (2) Goodwin’s suit.

Question 2

Note: The effective date for this question is **April 22, 2009**. In answering this question, please disregard any real world information that came out after the effective date.

From: Wendy I. Zeller [mailto:Ms.WIZ@work.com]
Sent: Tuesday, April 22, 2009 10:45 PM
To: Ms. WIZ Mailing List
Subject: CONFIDENTIAL – Project Genie

You've been assigned to work with me on Project Genie. Our client is **The Coca-Cola Company (NYSE:KO)**. KO is interested in acquiring 100% of **Coca-Cola Enterprises, Inc. (NYSE:CCE)**. KO has retained **Credit Suisse (NYSE: CS)** as their investment banker for this deal, and the CS banker leading this project told me that this will be a pure cash deal (i.e., KO will pay CCE shareholders for their shares in cash). 60% of the cash will come from KO, and the remaining 40% will be borrowed from **The Procter & Gamble Company (NYSE: PG)**, in a 10-year loan that PG can convert at any time until maturity into a 3% equity interest in KO. The details of the financing deal with PG have been already arranged – we need to focus on the deal with CCE. Also, don't worry about antitrust issues – our antitrust department is already looking into that, and preliminary signs suggest antitrust won't be a problem here.

Our immediate task is to figure out KO's "game plan" for dealing with CCE and its shareholders. Naturally, KO would like this to be a friendly deal. But we need to be prepared for the possibility that CCE's board will try to play hardball with us, and we may need to put pressure on it or even go hostile.

This is where you come in. I'm currently stuck in Washington D.C. helping the Treasury Department shore up U.S. banks (Project Sinkhole), so you're on your own handling Project Genie for now. Investigate CCE and find out information that relates to KO's ability to acquire 100% of CCE. The fact that KO is even considering this deal is, at this point, top secret – most top KO executives don't know about it yet. Therefore, you can't talk about this deal with KO or CCE executives, or with anyone else; you'll have to use only free public sources of information at this point.

You need to write a memo to KO's board recommending how to acquire 100% of CCE, considering all of KO's options, friendly and hostile. You should address what options CCE's board has to pressure KO, what options KO has to pressure CCE, and how each side might try to counter the other's strategy. The board will treat your memo as a blueprint for what they should do, so make sure to explain **in detail** to KO's board what they need to do, how CCE might react, etc. Tie your analysis closely to the particular circumstances of this transaction – simply going through the options from your law school class notes won't do.

Thanks and good luck!

Business Associations II – Spring 2009
Answer to Question 1

1. **Which slate of directors was elected?** Malus' slate.

(a) **Default rules:** DGCL 216(3): Directors elected by a plurality of votes of shares present. DGCL 212(a) – each SH entitled to one vote per share. Under default rules, Malus' slate was elected.

(i) Quorum in SH meeting? Yes: DGCL 216(1): Majority of shares entitled to vote (51M of 100M)

(b) **Did the bylaw amendment change default rule?** No; the amendment is invalid.

(i) **No quorum at BoD meeting:** DGCL 141(b) – Quorum is “majority of the total number of directors”, unless AoI determines otherwise, no lower than 1/3 of directors. Here, of three directors only Bron was present; no quorum unless AoI specified a quorum of 1/3.

(ii) **Change must be made in AoI, not bylaws:** DGCL 212(a) allows opting out of default only in AoI. This is different from *Capano*, because there the issue was a transfer of shares, not voting rights of shares, so DGCL 212(a) was inapplicable. Thus, even if the *Capano* reasoning applies here too (i.e., the amendment is about the rights of a shareholder, not a share), this only addresses DGCL 102(a)(4). DGCL 212(a) clearly applies and requires that the change be in the AoI.

(iii) **BoD lacks power to amend bylaws** unless AoI authorize it: DGCL 109(a).

(iv) **Bad Faith:** Even if amendment were otherwise valid, Bron has a CoI. She would lose her position as director if – as Malus suggests – Badoff will vote her out. Due to CoI, Bron does not benefit from BJR, and the decision does not seem fair to the corporation. Also, opportunistic use of Malus/Meek absence to introduce a new item on the agenda (the amendment) may breach fiduciary duty, in analogy to *Fogel*.

(v) **Blasius:** Bron (as the BoD) acted for the primary purpose of interfering with the free exercise of the SHs' franchise, and there is no compelling justification.

2. **Goodwin's suit** – Litigated on the merits, but probably Goodwin loses due to BJR

(a) **Should the suit be dismissed because of BoD's decision?** No

(i) **Direct or derivative?** Derivative

If direct, BoD decision is irrelevant because Goodwin, not Digger, has cause of action. Under *Tooley*:

(A) Who suffered the alleged harm? Digger, not its SHs – it is giving an interest free loan to a particular shareholder, thus losing the ability to use the money or the interest it could collect for lending it.

(B) Who would receive the benefit of recovery? Digger, not its SHs. Digger would either receive interest for the loan or will keep the money instead of lending it (via sale and option to repurchase) to Badoff.

Therefore, action is derivative. Because it's a derivative suit, Goodwin needs to make a demand on the BoD (unless excused), which he did. In making a demand Goodwin concedes that demand was required.¹ Court will consider BoD response to demand under BJR.

¹ Therefore a discussion of *Aronson* standards of demand futility was unnecessary, though I did consider this point where students concluded that Goodwin's e-mail was not a demand.

(ii) **Will court defer to BoD decision?** No

(A) Not a business judgment? Decision made immediately without investigation – but all directors already know the facts. Meek has legal expertise to evaluate merits of suit, but has CoI, so BoD may lack required independent legal expertise to make business judgment.

(B) Bad faith? No fraud or illegality, but two of three directors have CoI: Meek is accused of breaching fiduciary duties and would be personally liable if allegations are correct. Malus is the son of the person (Badoff) benefiting from the allegedly one-sided deal.

(b) Merits of the suit – Goodwin probably loses due to BJR

(i) **Authority:** Yes – Meek acted as a BoD committee authorized by BoD (DGCL 141(c)(2) – not among issues reserved to full BoD under DGCL 141(c)(2)(i)&(ii)).

(ii) **BJR** – Probably not rebutted

(A) Not a business judgment – No. Negotiations were “intense”, Meek is expert in finance, and received a fairness opinion on price of mine, so seems to be a business judgment.

(B) Bad faith – No. No fraud or illegality. No apparent CoI. Meek likes to appease people, but his actions don’t seem to amount to utter abandonment of his duties. Under *Beam* standard, Meek unlikely to risk reputational harm to his main career as a professor to appease Badoff or Malus, who at most can avoid reelecting him as director (Meek not otherwise affiliated with them). Transaction with controlling SH may create presumption of CoI, by analogy to *Weinberger* (though this is not a freeze out merger).

(1) Corporate waste – Probably not. Meek-Badoff deal amounts to a 3-year interest-free loan from Digger to Badoff, at a time when Digger is cash-constrained (and would have to pay 20% interest if it borrowed money). But this may be necessary to get the consent of a shareholder whose votes are possibly needed to facilitate the rights issue and repay the loan that is due in less than a month. If it is corporate waste, then BJR rebutted and Meek breached duty.

(iii) If BJR rebutted – **Fairness?** Close call, but I think it would be considered fair (see 2(b)(ii)(B)(1)). No evidence that Meek had entrenchment motive. Deal was possibly necessary to get SHs to approve rights issue, which itself was important to repay debts. But deal amounts to an interest-free loan at a time cash is scarce, and also discourages Digger from making improvements in acquired mine for 3 years, because Badoff would then repurchase the mine.

(iv) If BJR rebutted – **Ratification?** No.

(A) BoD ratification: Even if BoD vote was intended to ratify, majority of directors had CoI (see 2(a)(ii)(B)).

(B) SH ratification: SHs somewhat informed by Bron’s letter, but it’s hard to construe a vote approving the increase in authorized shares as ratifying Meek’s behavior. SHs may have felt compelled to allow the rights issue in order to pay the loan, even if they did not approve the deal with Badoff.