Business Organizations

FINAL EXAM

Spring 2022

Professor Kara Freel-Sparks

EXAM INSTRUCTIONS

There are three questions in this final exam. You have three hours to complete the exam. If you are using a computer to type the exam, employ 1.5-sentence spacing (used here). If you are handwriting the exam, space appropriately and ensure your answers are legible. Further exam instructions, following, are the same as given on the California Bar Exam:

"Your answer should demonstrate your ability to analyze the facts in the question, to tell the difference between material facts and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply the law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.
Your answer should be complete, but you should not volunteer information or discuss legal doctrines that are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application."

QUESTION #1

Armed with boundless energy and enthusiasm, Dixie, Trixie, and Pixie started a faerie-supply company, FSC. Trixie contributed $150,000 her parents gifted her, telling Dixie and Pixie she'd decided her karma was best served by "paying it forward" and avoiding all the negativity of any further liability.

Dixie contributed the $25,000 he'd saved by going vegan as a teenager. Dixie was a designer, and they all agreed he would design their faerie supplies. Pixie contributed no money but had worked as a salesperson and done so well in an accounting class they all agreed she would operate the business.

Despite all naysayers, FSC quickly became a success, with a profitable first year. Dixie believed this was due to his unparalleled design skills. His Faerie Lights Phantasm was a huge hit, so when the start-up Ogre General contacted him directly to purchase $850,000 of Faerie Lights Phantasms, he gleefully accepted and signed the sales contract. His cousin was OG's purchasing agent, so he was sure it was fine.

When Pixie and Trixie discovered the contract, Pixie researched OG and learned that it was a start-up with no credit. She contacted OG and demanded a credit card for the sale, and stated that the credit card would be charged prior to product delivery. OG refused, pointing out the Net 30 day terms of its sales contract with FSC. Over Dixie's screaming, FSC refused to deliver the Faerie Lights Phantasms. OG sued for breach of contract

Trixie became quite concerned about how Dixie and Pixie were managing FSC. She contacted Phantasms, Inc., FSC's phantasm supplier. She told Phantasms' CEO, "Dixie is a designer and has no authority to order parts. All the business stuff is Pixie's job."

Dixie later wanted to build Faerie Lights Phantasms on spec for a local brewery and placed a substantial order with Phantasm, Inc. FSC refused to pay for the order, and Phantasms, Inc. sued FSC for breach of contract. Insulted beyond all measure, Dixie declared, "You shall rue the day you clipped this Phoenix's wings! My genius and I are leaving," and stormed out, never to return.

Shortly thereafter, FSC went out of business, owing its creditors over $600,000.

1. How should FSC's debts be allocated? Discuss.
2. Is OG likely to succeed in its suit against FSC? Discuss.
3. Is Phantasms, Inc. likely to succeed in its suit against FSC? Discuss.
4. Do Trixie and Pixie have a cause of action against Dixie? Discuss.

QUESTION #2

Anton incorporated his art supply company, Faboo, Inc., years ago when he decided to open a retail space. Anton bought all Faboo, Inc.'s shares for $25 and loaned it $75,000 for its expansion. Anton elected himself and two of his close friends to the Board of Directors. The Board subsequently elected Anton as President and approved a fifteen year retail space lease.

Faboo leased retail space for fifteen years in an older strip-mall located off the main drag. The lease was a standard triple-net lease in which the lessee pays all property-related expenses, including property taxes and maintenance. Anton managed the store and was paid 10% of the gross revenues as compensation.

Anton's investor friend Corrina subsequently bought 25% of Faboo's stock.

Faboo's Board approved a contract to buy 45% of bedazzling-supply company Shiny, Co.'s inventory, which Anton owns.

Anton decided to kick his art career into high gear and is taking home Faboo's inventory to create his pieces. He considers the inventory an informal bonus of owning and working for the company.

Faboo has profits some years and not others, often because maintenance on an older building affects the bottom line. Some years dividends are paid, others they are not. The Board of Directors may go several years without a meeting, and other then the occasional hand-scrawled agreement, meeting notes are not often taken.

Tragically, the pandemic ended retail operations in many sectors and the art world was one. Faboo, Inc. went out of business with a mere $4,000 in cash remaining. Among the claims against Faboo were $10,000 owed its major supplier, BigTime, and the $75,000 loaned it by Anton. BigTime and Corrina, individually, filed lawsuits against Faboo and Anton.

1. On what legal theory, if any, can BigTime reasonably seek to recover against Anton on its claims against Faboo?
2. Does Corrina have a cause of action against Anton, either derivatively or personally? Discuss.
3. If Faboo, Inc. is forced into bankruptcy court, will Anton be able to collect from Faboo any portion of his $75,000 loan? Discuss.

QUESTION #3

Xenon is the President of StarShine, Inc. a space resource extraction company and publicly traded corporation. She is also a director on its Board of Directors and owns a whopping 15% of its shares. For the past five years, StarShine has averaged EBITDA (earnings before interest, taxes, depreciation and amortization) of 50% of its gross sales.

StarShine has not paid a dividend or made any other distribution to its shareholders. This was planned so that StarShine will have substantial retained earnings to make it more attractive for sale to another company - or to entrap another company in a hostile takeover. Either way, Xenon figures she wins.

With Board approval, Xenon began initial negotiations with EdisonCo's corporate officers for StarShine's purchase. Recent Hubble telescope footage of yet another possible water source on Mars has blown up the news, and Xenon hopes to take advantage of the resulting spike in StarShine's stock to get the best price for the corporation. EdisonCo already has a crew enroute to Mars and so will be able to verify or disclaim the possible water source within 60 days, so Xenon is hoping to close the sale of StarShine fast. She has not submitted the plan to StarShine's shareholders for approval, nor has she obtained outside consultants' review of the possible terms of sale.

Subsequently, *WSJ Now*, a national financial newspaper, interviewed Xenon regarding the possible sale of StarShine. In that article, Xenon was accurately quoted as saying, "There are no pending discussions regarding StarShine's sale or merger."

YoYo owns 5% of StarShine's shares and is concerned that he hasn't received a single dividend in five years...particularly when the company is doing so well. YoYo filed a lawsuit against Xenon and StarShine's other board members seeking a decree compelling the defendants to declare, and StarShine to pay, a dividend on its stock. Xenon and the other directors voted to have StarShine indemnify them for their defense costs. While his suit is pending, YoYo learned of the recent negotiations for sale of StarShine to EdisonCo. He amended his complaint to enjoin the sale and obtain damages from Xenon and the other directors for alleged breaches of fiduciary duty in the negotiations for an expedited sale and for Xenon's false statement reported in *WSJ Now* that StarShine was not for sale.

1. How should YoYo's attempt to compel payment of a dividend be decided? Discuss.
2. Can StarShine lawfully provide indemnity to Xenon and the other directors for their legal costs incurred in defending YoYo's suit? Discuss.

3. Are Xenon and the other Board directors liable to YoYo because of Xenon's statement quoted in *WSJ Now*, and, if so, to what relief is YoYo entitled? Discuss.
4. What responsibilities do Xenon and the other StarShine directors have in seeking to effect the expedited sale of StarShine to EdisonCo, and have they fulfilled those responsibilities? Discuss.

FINAL EXAM, SPRING 2022
PROFESSOR KARA FREEL-SPARKS
ANSWER OUTLINE

EXAM QUESTION #1

#1 re: Allocation of FSC's debt

1. Was FSC a limited partnership?
    1. Define LP, 3 parts
    2. LP formation requires filing w/ SOS
    3. Trixie's statement re: limiting her liability shows intent to form LP
    4. Despite this, lack of filing w/ SOS = no LP
2. Was FSC a general partnership?
    1. Define GP, 3 parts
    2. When D,T, and Px agreed to form and operate FSC for profit, they formed GP
        1. No written PA required
    3. FSC is GP
    4. Joint and several liability for all Ps in GP
3. Order of Payment in GP Dissolution
    1. When GP dissolved and assets reduced to cash, must be distributed in the following order:
        1. creditors, including P creditors
        2. non-creditor Ps to return initial capital contributions
            1. Issue w/D possible wrongful disassociation: Possible delay, reduction in, or absence of, repaying his contribution
        3. Ps share profits and losses equally absent an agreement stating otherwise
    2. Debts to creditors must be paid before T & D can have their contributions repaid
        1. Px did not make $ contribution
        2. Px not entitled to $ in dissolution other than reasonable compensation for windup-related services provided, absent an agreement stating otherwise
4. (possible points for discussion of D & P adhering to T's desire for $150K limited liability
    1. X points for bringing it up at all
    2. X points for D & Px bearing disproportionate amounts of deficiency if T's obligation exceeds her contribution
    3. X points for agreement between Ps not binding 3rd parties, T still J&S liable for FSC's debts)

#2 re: OG's suit against FSC

1. Actual authority
    1. Each P is an agent of FSC for purpose of its business
    2. Define AA:
        1. Authority that a P reasonably believes s/he has based on the communications between the P and the partnership
        2. Can be granted in the PA or by consent of Ps
        3. D did not have AA because Ps agreed Px would operate the business, sales background specifically mentioned
            1. (Plus, As a product designer, sales are not w/in D's job description)
2. Apparent Authority
    1. Define, 4 parts
        1. (poss points, under RUPA knowledge means subjective knowledge ie what 3rd party actually knew)

2. Factors for Ap A and therefore for OG, its reasonable belief:
    1. D was a partner
    2. Such sales w/in scope of FSC's business
    3. Under RUPA, any act of P for apparently carrying on of P's business binds partnership …
3. Factors against
    1. …UNLESS P had no actual authority to so act
    2. and OG knew it
        1. D's Cousin as OG's purchasing agent argues for this
        2. OG at least aware D was a designer, not a sales person
4. Last factors weigh against OG succeeding in the suit

#3 re Phantasms suit
1. Actual authority, same analysis
2. Apparent authority, ""

#4 re P&T CoA against D
1. Disassociation, possible wrongful
2. If wrongful, Recoveries
3. Required, windup or buyout

EXAM QUESTION #2

#1 personal liability in corp, CHC
1. Closely held corporation, define parameters
    1. Inc. no personal liability unless
2. Piercing corp veil
    1. Alter ego
    2. Fraud
    3. Undercapitalization
    4. Unfairness
3. could go either way based on strength of argument

#2 C coA against A, derivative or personal
1. shareholders gen'l no fiduciary duties to each other
2. CHC majority to minority could be
3. Oppression by majority shareholder?
4. A's duty to corp as director
5. Duties of loyalty, care define and analyze
6. derivative action, same - 3 factors/requirements
    1. demand futile? issue
7. C's deriv. action possible but recovery limited

#3 $75K loan recovery by A
1. no, nothing left to pay him his claim subordinate to BT's

EXAM QUESTION #3

#1 SH compelling dividend
1. BoD's discretion
2. Y's argument
3. Unlikely to succeed

#2 BoDs indemnified by SS?

1. Gen'l reimbursement of BoD for corp's expenses, but not at issue here
2. Successful defense by director = mandatory indemnification for expenses of suit
3. Further analysis etc etc

#3 X and other BoDs liability for X's lie

1. Rule 10b-5 definition and analysis
2. Misrepresentation, 4 parts

#4 Directors' responsibility re sale

1. Duty of Care, definition, analysis
2. Duty to submit to shareholders for approval, timing

1)

(1) HOW WILL FSC's DEBT BE DISTRIBUTED?

CORPORATION NOT FORMED.

There are no facts in this case that give rise to a business entity such as a Corporation, as their is no mention of a proper filing of such Articles of Incorporation with the Secretary of State, nor any identifyer in the name of "Corporation" "Incorporated" "Limited" Therefore, the formation of a Corporation will not be analyzed further.

LIMITED LIABILITY CORPORATION NOT FORMED.

However, the name of the company is faerie-supply company, FSC does raise the question if this is a Limited Liability Company. For FSC to be a limited liability company, which provides limited liability to the members, there must be a Articles of Incorporation for a Limited Liability Company. However, the facts show there was no such filing. Thus, this evaluation advances no further.

LIMITED PARTNERSHIP NOT FORMED.

A limited partnership is one where there is at least one partner serving as a general partner. This partner has rights and control over the management of the business. This individual does not have limited liability. However, on the other hand, there is at least one other partner who is a limited partner. This individual does provides equity, but they do not have any control over the business operations. This person does have the shield of limited liability protections. This entity is formed with a filing of a Limited Partnership with the State.

Here the facts do not present any filing, nor any name, such as LP. Although, Trixie may argue she only provided funds to FSC and does not engage in the business the, her argument is untrue because she did engage in business dealings when she called Phantasm "Dixie is the designer...business stuff is Pixie's" Therefore, a limited partnership would fail as there is no filing and no member serving int he limited partnership capacity.

Next, we consider General Partnership.

GENERAL PARTNERSHIP

A general partnership is formed without the formalities of submitting any documentation to the state. Also, a general partnership will be formed when individuals agree to associate for the purpose where they intend to share profits and losses. Each partner will have liability for the partnerships liabilities, which is joint and several liability.

Here, there there are no facts that Dixie (D) Trixie (T) and Pixie (P) submitted any documents to form any type of limited partnership, or other entity that requires formal certifications submitted to the secretary of state. Further, there are individuals that have provided equity in funds or work in an effort to carry on business in a manner where they would share control in the business activities, and would share in the profits and losses liability for the members is unlimited.

The default unincorporated business entity, General Partnership was formed.

BLACK ROCK DOCTRINE

When a company becomes insolvent, the Black Rock Doctrine will provide a subordination mechanism whereby the creditor will take priority over the equity of an owner.

Here, FSC went out of business and the facts show the company has become insolvent. Because the company funds are $600,000 in deficit, the creditors, will be owed their distribution prior to equity distribution. The actual obligations of creditors will depend on the evaluation below. Therefore, providing funds are owed to creditors, they will be paid prior to distribution of funds to the partners.

DISSOLUTION

In a partnership, dissolution of the business may be voluntary or involuntary. A involuntary dissolution could be due to court order, wheras, a voluntary dissolution could be because of an agreed upon dissolution, which appears to be the circumstances in this case as there is no litigation in the facts and the company is insolvent with what appears to be a good partnership turned sour. The business entity will need to follow a process in winding up, which is reviewed next.

WINDUP

The final value owed will depend on the determination of losses in the OG suit, and FSC's suit against FSC. However, absence clarity on full losses, as noted below, the general structure for a wind-up in this case is as follows. (1) liquidate, (2) pay creditors, (3) outstanding obligations from lawsuits, if successful, (4) distribution.

In this case, the assets are in the negative by $600,000. Thus, each partner will be jointly and severally liable. The only relief will be to P and/or D if they are able to succeed in direct claims against D.

CONCLUSION - A General Partnership was formed. Each party is jointly and severally liable to the debts of the company. The total value shared will depend on the actual final value of the losses - unless the court find a party will prevail in a direct action against a partner (which in this case will fail).

(2) Whether OGC will succeed in a suit against FSC?

BREACH OF CONTRACT

DID D HAVE AUTHORITY TO CONTRACT WITH OG for $850,000?

Supra, Partners have equal control of the company control and management. Therefore, D had control over contracts he engaged in on behalf of the company.

While his partners may argue D did not have authority, OG can rely on the doctrine of Apparent Authority.

APPARENT AUTHORITY

When am 3rd party reasonably relies on a representation of authority which is presented by the agent. In this case, D was a member of the partnership, and OG would have known his standing in the partnership because there was family relationship engaged in the business exchange. Therefore, OG would reasonably be under the impression that D had apparent authority by virtue of D's standing. This could also be seen as Inherent Authority. The argument agianst this would be that he did not engage in the business dealings. However, this is still a partnership, so there is not unequal authority in this case.

OG will be able to successfully claim Apparent Authority binds the Agreement between OG and FSC.

It should be noted, that the arrangement does raise concerns for FSC that it was not an arms length agreement, which means D may have acted inappropriately with this agreement. That will be discussed below.

CONCLUSION: OGC should succeed in their case of breach of contract, but their win will be fruitless because FSC is insolvent and OGC's interest is likely for specific performance which FSC will not be able to satisfy.

(3) Whether Phantasm, Inc succeed in a suit against FSC?

APPARENT AUTHORITY

Def. Supra.

Phantasm will argue there was apparent authority because they worked with D and D made orders in the past, so they continued on these prior dealings. They will also suggest that they know D was a partner, which means he should have equal authority to buy products for FSC. However, this argument should fail because the products were not shipped to FSC instead they went to a local brewery and that coupled with the notice (discussed below) chills Phantasm's argument.

Thus, the apparent authority argument from Phantasm will fail.

LINGERING AUTHORITY

Here, D ordered parts from Phantasm for a local brewery. This is after, Dixie informed Phantasm that "Dixie is a designer and has no authority to order parts. All the business stuff is Pixie's job. So, FSC will argue that in this particular order, which is subsequent

CONCLUSION. Phantasm should not prevail in a case against FSC for several reasons. First, Phantasm received notice that Dixie did not have authoirity and so this should defeat Phantasm's argument of apparent authority, but further, this would be unfair

Not Strong

enrichment to the brewery who gained the goods at no expense. So there are other contract issues that should considered that are not reviewed in this essay.

(4) Whether T and P have a cause of action against D.?

DUTY OF CARE

The partner owes the duty of care which is to act as a prudent person would reasonbly act under the same circumstance.

Here, D found engaged in entering into agreements that where the other members were not a party to, he signed off without checking the financial position of one company, then he later engaged with purchases from Phantasm possibly where he let the bill go to FSC when the goods were specifically for a brewery.

Therefore, D really failed the duty of care.

BJR NA

BJR is a presumuption that the partner acts in good faith, but the shield can be dismantled if the person acted by a conflict of interest. In this case, there was a conflict of interest because the familial contacts of cousin will mean there was unjust enrichment to a family member.

D breached the duty of care.

DUTY OF LOYALTY

Duty of loyalty is owed to partners. This includes ensuring the interests of the partnership are above the interests of the individual partner.

Here, D breached this duty because he had a conflict of interest when he engaged his cousin the the contract dealings.

CONCLUSION.P and T will have a direct claim against D for his acts in breach of his duty as a partner.

END OF EXAM

2)

(1) CAN BIG TIME RECOVER AGAINST ANTON, WHAT THEORY?

CORPORATION FORMED.

The facts presume a corporation is formed as there is no indication of defective formation. Further, the facts reflect, Anton incorporated his art supply company, "Inc" some years ago.

A corporation is an entity where the sharholders are separate from the entity, and the shareholders enjoy limited liability.

There are certain companies, however, that have a special designation, these are CLOSELY HELD CORPORATIONS (or S-Corp) because they have a small number of directors, who are sometimes of familial or friend relationships.

Here, we have Anton serving as the Board of Directors, and he has elected his two friends to the board. This corporation has few members, and at first one shareholder. Thus, FABOO is a closely held corporation

Therefore, as the facts present, a valid Corporation has been formed, and it is designated a closely held corporation.

PEIRCING THE CORPORATE VEIL

As corporation members have limited liability protections, a closely held corporation could be pierced, which will hold the corporation members personally liable. To piece this veil, the following must be shown.

(1) ALTER EGO

Alter ego is presented when the members do not properly follow formalities or commingle assets.

Here, we have Anton not following corporate formalities as there were meetings missed where the board held over without votes annually. This alone is not not sufficient to pierce a veil, but Anton further commingled assets because it is said that he took home inventory to create pieces, which will have a negative impact on Faboos balance sheet.

Therefore, there is a showing of an alter ego by anton commingling funds by taking property for his own and for not consistently following formalities.

(2) Sufficient Capital

Next is the question, did Anton adequately fund Faboo at the time of formation.

Here, A bought shares for $25. and loaned it $75,000.

The $75,000 is a debt, and the $25 funds of equity is not sufficient to enter into a lease. Further, while it is not an issue that Anton be compensated fairly, which 10% may be fair, this is questionalble given the upside down financial position that the company started with.

Therefore, Anton did not sufficiently fund Faboo

(3) FRAUD

There is no facts that raise a belief that Anton acted with any intent to commit fraud

Thus, there is no intent to commit fraud noted.

(4) ESTOPPEL

There are no claims in the facts raise piercing the corporate veil by estoppel.

CONCLUSION. For fairness to Big Time, they will likely prevail in piercing the corporate veil.

(2) DOES CORINA HAVE A CLAIM AGAINST ANTON

DIRECT ACTION AGAINST ANTON

A direct action is when the member has a direct claim by improper acts of the Directors.

Because this is a closely held corporation, Corina will have an action against the majority shareholder. C's claim will be based on Anton not maintaining the upmost duty to fellow shareholders.

DUTY OF CARE

duty of care requires A to act as a prudent person would do in like circumstances.

As this is a closely held corporation, Anton has a duty to his fellow shareholders where he should in oppression (Donhue) of a minority shareholder. In such cases, the minority shareholder will be able to bring a direct action against Anton.

Therefore, A breached the duty of care.

DUTY OF LOYALTY

A has a duty to act in the best interests of the company over his own.

C will also raise that A breached the duty of loyalty because he engaged in self-dealing because he had a conflict by entering into business by entering into a contract with bedazzeling- supply co. This was a company that Anton also owned, so there was a conflict of interest.

A will argue that there was full disclosure of the purchase, and it was approved, but the board members.

Therefore, Anton breached a duty of loyalty

DERIVATIVE ACTION

C was not issued stock. Therefore, she may lose the claim for a derivative action.

CONCLUSION. Corina will prevail in her direct action.

(3) CAN ANTON RECOVER FROM ANTON

Anot will not likely to recover his $75,000 for two reasons.

First, it is likely Corina will prevail in her lawsuit.

Second, the BLACK ROCK DOCTINE

Black Rock Doctine will render a insolvent company to first pay its creditors prior to payment to the equity owners.
A is an equity owner and creditors will therefore be paid first.

Third,

$4,000 assets, minus claims of $10,000 owed to Big Time. Thus, after the effect of Big Time's payment, which will leapfrog any payment to Anton. Anton will not receive any

funds after windup. Further, Anton may be liable to C for her direct lawsuit. (Also, if the derivative claim proceeds will be paid to the company, which will result in changes to the payout distribution.)

END OF EXAM

3)

Compelled Dividends-

Unless otherwise stated in the bylaws, corporations do not have to pay dividends. The board can decide to pay dividends as it chooses or is fiscally able. As long as the board is not paying dividends out unfairly or excluding members of the class of stock it is likely that not paying dividends is a valid form of corporate management.

Unocal-

The plan to hold onto corporate earnings in case of corporate takeover will be analysed under Unocal. This plan is occurring before they are merging or a corporate take over is happening, so it will have less scrutiny and be weighed under the Business Judgement Rule. If the plan is made while the corporate take over is in process, the courts will enhance scrutiny and look at if good faith and a reasonable investigation lead the board to believe their was a danger to the corporation and if the response was appropriate to the level of the threat.

Here, there is really no reason to compel a dividend. We have no reason to believe the board is being devious in their plans or receiving an improper benefit. They are executing a plan that will give them a better position in a merger or takeover transaction. This is a reasonable use of business judgement. Unless Yoyo can show others receiving a benefit and he is not, he has no merit. Xenon holds 15 percent and is not receiving dividends. If he is unhappy with the boards decisions, elect a new board or sell your stock.

Yoyo most likely has no claim to compel a dividend.

Indemnification-

If Yoyo brings a direct or derivative suit, Starshine can choose to legally indemnify their board of directors. However, all the board members are interested parties in the transaction. They will have to show they had approval from the shareholders or the decision was fair for the corporation and if not it will Breach their Duty of Loyalty. It is unlikely the decision will be deemed fair, as the corporation is not receiving any monetary benefit. They will have to have approval from disinterested board members (if any), or approval from the shareholders. The corporation can indemnify the board members, but the board cannot chose to indemnify themselves. The board members can point to the by-laws if there is any word on indemnification, in the fact pattern there is none.

The board can be indemnified. However, it was done improperly

Are Xenon and the other board directors liable to Yoyo because of Xenons Statement?

10B-5 -

Any person who through the instrumentalities of interstate commerce makes an untrue statement or omits a statement of material fact in connection with the sale of any security may be held liable under 10B-5. In a claim of 10B-5 courts will evaluate 1. Scienter 2. Reliance 3. Causation 4. Materiality.

1. Scienter is the intent to deceive or defraud.

Here, the element of scienter is likely satisfied. Xenon made a statement that their was no pending discussions regarding sale or merger when she was knew of the expedited talks with Edison Co. Xenon's knowledge the statement was false, which satisfies scienter.

2. Reliance-

The statement must be relied upon in the sale or purchase of any security. When omissions occur reliance is presumed but rebuttable. In publicly traded corporations, some jurisdictions allow a fraud on the market theory that you relied that the market reflected accurate information.

Here, Yoyo did not trade or purchase any security, so he cannot show reliance on the statement.

3. Causation-

Causation you have to show that the statement or misstatement caused your damages.

Here, Yoyo did not suffer any damages as he did not participate in any purchase or sale of security.

4. Materiality-

Materiality is dependent on whether or not a reasonable person would have found the information important in deciding or refraining from purchasing a stock or security. With Pending events courts will apply the probability and magnitude test to see if the statements were material.

Here, the merger is in the early stages as they have not even begun to work on "possible terms". The discussions have begun but have not moved to a serious or imminent state. The magnitude of the event is huge as it would be a sale of the company. The courts will likely consider this material, because even initial talks of such a huge purchase would be considered material by a reasonable person.

Here, Yoyo likely has no claim under 10B-5 as he did not purchase or sell a security based off the statement.

What responsibility do Xenon and the other Starshine directors have in seeking the expedited sale?

Duty of Care-

The duty of care requires that the board act in a way that a reasonable or prudent person would in a similar situation. This duty covers the duty to do accurate research when making a decision, and not making an uninformed decision.

The board here is trying to move quickly through a sale. They owe the shareholders a duty of care, and must stop and do adequate research on the deal they are getting into. There are no facts to state that they have not but the quick sale can lead to an uniformed or poor decision.

The board owes a duty of care.

Duty of Loyalty-

The duty of loyalty requires that board act with a reasonable belief that what they are doing is in the best interest of the company.

Here, the board will have to avoid seeking deals which personally benefits them more than the other shareholders. They cannot let side deals or personal interest be put ahead of the interest of the company.

The board owes a duty of loyalty.

Revlon-

Once the company sale is imminent, the board owes a duty to get the best price.

Here, the board will have to seek the best price once the sale of the company becomes imminent. This may include looking at other offers, and consdiering mergers with other companies if that's at the best interest of the corporation.

Ultimately, Xenon and the Board of Directors are representatives of the shareholders. They should enter into the business agreement with the best interest of the shareholder in mind. This will be accomplished by following their fiduciary duties and getting the best deal they can for the compnay

END OF EXAM