Kern County College of Law

343B Business Organizations

Final Examination

Spring 2025

Prof. J. Harvey

Instructions:

This exam consists of one (1) question with four (4) sub-sections.

You will be given 3 hours to complete the examination.

KCCL
Business Organizations II
Spring 2025
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FINAL EXAMINATION

MedTech Innovations, Inc. is a publicly traded corporation that manufactures medical devices. The board of directors, led by Chairperson Dana Wilson, receives a buyout offer from GlobalHealth Corp at $75 per share, representing a $10 premium over the current market price. Before disclosing the offer to shareholders, three of the corporation's nine directors, including Wilson, purchase additional shares of MedTech stock. One week later, however, the full board rejects GlobalHealth's offer without consulting financial advisors. The vote was 5-4, with Wilson and the other two directors who recently purchased additional MedTech stock in the minority.

Two days after the rejection, Wilson meets privately with the CEO of GlobalHealth and negotiates a position as Executive Vice President with a compensation package worth $3.5 million annually if the acquisition proceeds at $70 per share. Wilson then convinces the board to reconsider and approve the acquisition at the lower price, without disclosing her arrangement with GlobalHealth.

After the board approves the acquisition, the transaction is structured as a merger in which MedTech will become a wholly-owned subsidiary of GlobalHealth. MedTech's articles of incorporation require a two-thirds shareholder majority for approval of any merger. Wilson, concerned about achieving the necessary votes, directs MedTech's investor relations team to release a statement highlighting only positive aspects of the deal while omitting material information about recent breakthroughs in MedTech's research division that could significantly increase share value within six months. Additionally, the proxy materials fail to disclose Wilson's future employment arrangement with GlobalHealth.

To further improve the odds of securing approval, the board amends MedTech's bylaws five days before the shareholder meeting, reducing the merger approval threshold from two-thirds to a simple majority. This amendment is made pursuant to a bylaw provision allowing the board general authority to amend the bylaws, though MedTech's articles and bylaws are both silent on the specific issue of whether the board can amend shareholder voting requirements for fundamental transactions. Institutional investor DarkStone Fund, which owns 18% of MedTech's shares, discovers the bylaw change and threatens litigation. Meanwhile, activist investor Carl Jenkins, who owns 7% of MedTech shares, begins soliciting proxies against the merger. In response, Wilson negotiates a side deal promising Jenkins that his separate medical supply company will receive exclusive distribution rights for certain GlobalHealth products post-merger if he supports the transaction.

You are a new associate attorney at the prestigious law firm of Cheatham, Quick & Hyde. Your firm has just been retained by Prof. Harvey, a MedTech shareholder, who has asked for a breakdown of his and MedTech's rights and obligations in connection with the facts and circumstances described above. Your supervising partner, William Moore, asks you to draft an analytical memorandum addressing each of the following:

1. **Analyze any potential breaches of fiduciary duty by Chairperson Wilson on the foregoing facts. Discuss the applicable legal standards, available theories of liability, potential defenses, and likely outcomes if a MedTech shareholder brings derivative litigation against Wilson.**

2. **Analyze any potential violations of SEC Rule 10b-5 by Chairperson Wilson and the other directors who purchased MedTech shares before the disclosure of the buyout offer. Discuss the applicable legal standards, potential defenses, and likely outcomes if the SEC were to initiate an enforcement action in response to the transactions.**

3. **What legal options are available to DarkStone and other dissenting MedTech shareholders who oppose the bylaw amendment and merger? What claims could they assert and how likely would they be to succeed? Explain your analysis.**

4. **If Prof. Harvey were to assert claims against the MedTech board, on grounds that the price of $70 that was agreed to for the merger is unfairly low, would the business judgment rule protect the board members from liability? Why or why not? Explain your analysis.**

1)

1. Wilson's many breaches of her fiduciary duties.

Corporations, a business entity formed by filing articles of incorporation with the secretary of state, are governed by their articles of incorporation and bylaws. A corporation is managed by the board of directors. The board of directors will typically appoint officers to handle day-to-day management tasks, but may also manage the corporation directly. Some corporations are managed directly by shareholders as provided in the articles of incorporation and bylaws of those corporations.

In a typical corporation, the directors are chosen by a majority vote of the shareholders. The directors have fiduciary duties to the corporation, its shareholders, and prospective shareholders. Fiduciary duties of a director include the duty of disclosure, the duty of loyalty, and the duty of care.

A) Duty of Disclosure

The duty of disclosure requires a director of a corporation to disclose to the other directors, shareholders, and the public (in the case of a publicly-traded corporation) information which is material to the business of the corporation, its financial condition, external and internal factors impacting its ability to do business, and other information which would be material to the decision of whether or not to continue as an investor in the corporation. A breach of this duty can create liability for a director who breaches this duty.

Wilson breached the duty of disclosure when she failed to disclose GlobalHealth's first offer to the shareholders.

Here, Wilson is the chairperson of the board of directors of MedTech Innovations, Inc. Wilson has received a merger offer from another corporation (GlobalHealth) for $75 per share--a price $10 above its current market price. Wilson did not immediately disclose that information to shareholders or the public. Instead, she and two other directors (1/3 of the board) decided to purchase additional shares of MedTech. Wilson breached her duty to disclose the offer to the shareholders. The shareholders were entitled to disclosure of this information because it was material to their decision to remain investors or to increase their own holdings.

Information is "material" when it would be considered important to the decision to buy or sell (or refrain from buying or selling) securities. The offer to purchase shares at a price which is $10 above its current market price would certainly be material to anyone who held shares of MedTech or

anyone who was considering buying shares. A shareholder of MedTech would have been disinclined to sell their shares before the merger, because the shares were trading on the open market at $65. The decision to hold could have, if the merger were approved, resulted in a windfall to existing shareholders of $10 per share.

Further bolstering the argument that this information was material was the decision of Wilson and two other directors to purchase additional shares. This was a Rule 10b-5 violation, which will be discussed in part 2, *infra*. The information was important enough to Wilson and the other two directors that they increased their own holdings in anticipation of being able to sell the shares for a higher value, increasing their own profits.

Wilson breached her duty of disclosure again when she negotiated a new position with GlobalHealth contingent on a successful acquisition.

Wilson had a separate and distinct duty to disclose a conflict of interest which arose when she negotiated a new, high-paying C-suite job with GlobalHealth. Wilson negotiated a $3.5M annual salary with GlobalHealth and did not disclose the offer to the rest of the board. Wilson would argue that this was not material information and as such would not have breached her duty to disclose. But Wilson's argument fails. Wilson's new position is contingent on MedTech selling itself to GlobalHealth for a now-lower price of $70 per share, which would only be $5 over the current market price. Further, Wilson has a strong personal incentive to argue in favor of the acquisition to the board. The board is not in the proper position to analyze Wilson's recommendation, because they are missing a critical fact: that Wilson herself will reap strong personal financial gain from the acquisition proceeding. This information would be material to the credibility of Wilson's recommendation to reconsider and approve the acquisition. Wilson has therefore breached her fiduciary duty of disclosure to the other board members.

Wilson breached her duty to disclose for a third time when she failed to direct the investor relations team to make a complete disclosure about the acquisition.

Wilson's third breach occurred when she directed the investor relations team to issue a statement which omitted information about MedTech's recent breakthroughs. The decision to accept an acquisition is a fundamental change in the corporate structure, and the price at which the acquisition occurs has significant ramifications for the investors. Whether the shareholders of the corporation should accept at a price of $70 per share depends heavily on whether or not the expected share price in the future was more or less than $70. Every shareholder of MedTech was entitled to a complete disclosure of both the positive aspects of the acquisition *and* the possibility that MedTech's

own share price could meet or exceed the acquisition price based on their own research and development.

If fewer than two-thirds of the shareholders believed it was in their best interest to agree to the acquisition, those shareholders would vote "no" on the proposed action, and the acquisition would fail. The shareholders cannot make a knowing and intelligent decision on how to vote if they do not have the complete information. Wilson has therefore, again, breached her fiduciary duty of disclosure.

Wilson did not breach her duty of disclosure when she failed to disclose her future employment arrangement with GlobalHealth.

It is unlikely that Wilson's omission to the *shareholders* about her future employment arrangement would be considered a material breach. The disclosure of future employment to the shareholders is not particularly relevant or material to their decision to agree to the acquisition. There are probably few, if any, shareholders who care where one of the directors of MedTech would go work after the acquisition were complete, or what she was paid. That information does not tend to have an immediate material impact on the share price of MedTech or the GlobalHealth, so it is unlikely that the shareholders would consider it material. The existing shareholders of MedTech will not become shareholders of GlobalHealth--once they accept the acquisition, they are paid for their shares and are out of the picture. The information about who is going to be the executive vice president of the new entity is not relevant to persons who will not become shareholders of the new entity. For these reasons, the failure to disclose this information to the shareholders was not material and therefore not a breach of Wilson's fiduciary duties.

B) Duty of Loyalty

In addition to the duty to disclose, the directors of a corporation have a duty of loyalty to the corporation. The duty of loyalty, at its heart, requires that the directors place the interests of the corporation above their own personal gain. In other words, the director may not personally profit at the expense of the corporation. The duty of loyalty is separate and distinct from the duty of disclosure.

Wilson breached her duty of loyalty by negotiating a second acquisition offer from GlobalHealth.

GlobalHealth's first offer to acquire MedTech was for a price of $75 per share, which was $10 over the current market price. The second offer was for $70 per share--half the value over market as the

first offer. It appears that Wilson was motivated to pursue the second offer for two reasons: she had increased her own personal holdings of MedTech stock, on which she would still turn a profit if it were acquired at $5 over market, and she was offered a high-paying position of great importance in the new entity.

The second offer was half as lucrative as the first. Wilson essentially cut the potential profits of MedTech's shareholders in half by negotiating a new deal with GlobalHealth. Wilson would argue that she did no such thing because it was the board as a whole that rejected GlobalHealth's first offer. This argument has some merit, but not much. It is true that the full board breached its duty of care to the corporation when it rejected the first offer (discussed further in Part 4, *infra.*) Further, by negotiating a second deal with GlobalHealth, Wilson has placed her own interest in a new job ahead of MedTech's interests in fully developing their new product lines which could increase MedTech's value without the merger. Therefore, Wilson has breached her fiduciary duty of loyalty to the corporation by personally benefiting at the expense of the corporation.

Wilson may have breached her duty of loyalty by negotiating a side deal with Jenkins.

The directors of a corporation have the duty to refrain from diverting business opportunities from their corporations. If the corporation has an interest or expectation in a business opportunity, and the director diverts that opportunity from the corporation to either himself or a competitor, he has breached his duty of loyalty to the corporation.

To prevent a proxy battle with a 7% shareholder of MedTech, Wilson negotiated with Jenkins a side deal to distribute GlobalHealth products from his own medical supply company. It is unclear from these facts whether this is a breach of the duty of loyalty or not.

Jenkins owns a medical supply company, which is in the same general field as MedTech (who manufacture medical devices.) GlobalHealth's primary business or purpose is not given in the facts, but based on the name of the company, it can be assumed that GlobalHealth operates in the same general space. If either GlobalHealth or Jenkins's medical supply company are competitors of MedTech, either before or after the merger was complete, then Wilson's side deal could have diverted a valid business opportunity from MedTech to Jenkins (or GlobalHealth, since the GlobalHealth products were the subject of the distribution rights.) In any event, if MedTech had any sort of interest or expectation from the distribution rights of GlobalHealth's products (or the interest or expectation in preventing those distribution rights from falling to Jenkins) then Wilson has breached her duty of loyalty by negotiating the distribution with Jenkins.

It is also possible that Wilson may have breached her duty of care to the new entity by acting outside of her actual authority. Because the merger is not yet complete, and she is not yet actually an executive vice president or anything, but is acting with the apparent authority of GlobalHealth by negotiating a distribution deal with Jenkins, Wilson may have created liability for GlobalHealth if the merger is not actually approved but Jenkins still insists on enforcing the distribution deal. GlobalHealth may be bound by Wilson's agreement and liable for a breach if they do not honor the distribution agreement. In that situation, Wilson would also be liable to GlobalHealth.

A derivative action against MedTech by a MedTech shareholder would be successful, but is unlikely to get off the ground.

A shareholder may step into the corporation's shoes and assert a corporation's interests via derivative action under certain circumstances. The distinction between direct shareholder action and derivative action arises from the nature of the claim.

If the shareholder has their own direct claim against the corporation (for example, if the shareholder was entitled to a dividend or other distribution but was not paid) then the shareholder would sue the corporation directly in a direct shareholder action. The shareholder would be the plaintiff, and the corporation would be the defendant. If the shareholder is successful on a direct action, the corporation pays the shareholder because the shareholder is asserting their own interests.

If, on the other hand, the corporation has a valid claim but the directors of the corporation are unwilling to pursue the claim on behalf of the corporation, the shareholder may assert the claim on behalf of the corporation via a derivative action. If the shareholder is successful in their derivative action, the corporation receives the benefit of the judgment, but the shareholder is entitled to their costs and attorney's fees, which would typically be paid by the corporation. There are several requirements for a derivative action.

The shareholder must notify the board that the corporation has a claim and demand the board take action to resolve it.

For any derivative action (with very few exceptions) the shareholder must notify the corporation through its board that the corporation has a claim and demand that the board of directors take action on the claim. The notice must be delivered in writing to the corporation. After giving notice, a 90 day waiting period begins.

During that 90 days, the corporation has the opportunity to either assert its own claim in court, or remedy the claim in another way. If the derivative claim was to enjoin an illegal act that one or more

directors was undertaking, the board may in many circumstances be able to take corrective action without involving the court at all.

Written notice is not required if the notice would be futile.

This written notice is not required if giving notice would be futile. This is ordinarily the case in very small corporations, where the board is unwilling to take corrective action because they are all "in on it"--if the entire board is embezzling money from the corporation, it is unlikely that the board would sue itself to stop embezzling money, or voluntarily disgorge the embezzled funds back to the corporation. In these types of limited circumstances, the written notice requirement can be waived as futile.

The proper notice to MedTech would likely cause MedTech to enforce its own rights, making the derivative action unnecessary in this case.

Here, it is not at all clear (or even likely) that notice to the board of the existence of a claim would be futile. The proposed acquisition had already been voted down once, and a majority of the board of directors was not in on the scheme to purchase shares prior to the acquisition becoming public. Additionally, 5 of the 9 board members have already voted down the acquisition once. It is highly likely that those 5 board members would be very interested in the activities of Wilson and the other directors, and would be perfectly motivated to assert the corporation's claims directly.

If, however, the board were not persuaded to take action, the shareholder could commence a derivative action after 90 days. The shareholder would have valid causes of action against Wilson for the breaches of fiduciary duties described above, and two other board members for insider trading violations, discussed in Part 2 *infra*. If the shareholder were successful, the three board members would have to disgorge any profits or other wrongfully obtained gains, and pay the plaintiff's attorney's fees.

2. The 10b-5 violations of Wilson and the other board members.

SEC Rule 10b-5 is aimed at preventing unfair securities transactions. Rule 10b-5 prevents two types of securities violations: securities fraud and insider trading.

Securities fraud occurs when: a fraudulent statement or omission from a statement, made with the knowledge that the statement is false or with reckless disregard for the truth of the statement, affects the sale or transfer of securities, and the transaction involves the instrumentalities of interstate commerce, the mail system, or a national stock exchange. A private plaintiff asserting a 10b-5

violation must prove they relied on the statement and was harmed. There is no such requirement when the shares are publicly-traded under the fraud on the market exception. Under this exception, it is presumed that the entire market for the shares of the corporation in question are relying on truthful and complete disclosures of the board when determining the fair market value for the securities in question.

Insider trading occurs when a director, officer, or shareholder who owns at least 10% of the outstanding shares of a corporation breaches their fiduciary duty in connection with the sale or transfer of securities.

Rule 10b-5 applies to the exchange of securities in corporations traded on a national stock exchange, or in the case of corporations that are not publicly traded on a stock exchange, the corporation has at least 2,000 shareholders (or 500 non-qualified shareholders) and total assets of $20,000,000 or more.

Federal court is the only jurisdiction where a 10b-5 claim may be litigated. A 10b-5 claim may not be brought in a state court. If the corporate size requirements of Rule 10b-5 are not met, or the fraud did not occur over the means of interstate commerce or a stock exchange, then a plaintiff who is harmed by this type of action may still pursue a common law tort claim for fraudulent misrepresentation, fraudulent omission of material fact, or similar claim in state court.

Here, MedTech is a qualifying organization because it is a publicly traded corporation. Its directors, officers, and 10% shareholders are all subject to the provisions of rule 10b-5. The transactions in question occurred on a public exchange.

Wilson and the other two directors who traded stock after the first offer from GlobalHealth committed a 10b-5 violation.

A 10b-5 violation occurs when a director, officer, or shareholder who holds more than 10% of the outstanding shares of a qualifying corporation engage in securities transactions using inside information. Inside information is information that is not publicly disclosed but is material to the decision to buy or sell securities.

Here, 3 of the 9 board members purchased stock after GlobalHealth offered to buy MedTech at $75 per share, $10 over the current market price. Each of the board members was a qualifying insider under 10b-5 because all directors of qualifying corporations are subject to 10b-5.

At the time the stock purchases were made, the information concerning the GlobalHealth merger was not public. If the information concerning the offer was made public, it would have had a dramatic impact on the share price. A stock trading at $65 per share would immediately jump to $75 per share if the information was generally known that there was a firm offer to buy at that price. The directors of MedTech all sought to profit from the increased share price, which is a violation of 10b-5. The information the directors of MedTech had was clearly material, which makes this a violation of 10b-5.

The facts do not state from whom the shares were purchased, but it can be assumed that because MedTech was a publicly traded corporation, Wilson and the other two directors purchased their shares from the public stock exchange. It is likely that the sellers of the shares purchased by the three directors in question would have sold at the $65 price had they known there was a possible merger at a firm offer price of $75. All of the elements of a 10b-5 violation for insider trading are therefore satisified and Wilson and the other two board members are liable for the violation.

The SEC is empowered to enforce the provisions of 10b-5 and can prosecute Wilson and the other two directors.

The SEC can enforce 10b-5 through several means. The SEC can fine violators, obtain court orders that any ill-gotten profits be disgorged to the corporation, or in extraordinary cases, criminally prosecute violators and seek jail time. An SEC enforcement action against Wilson and the other two board members would be successful because all the elements of a 10b-5 violation are present.

3. The rights of DarkStone and other shareholders.

A shareholder who wishes to sell their shares can compel a corporation to buy them back through dissenter's rights.

Shareholders who disagree with proposed actions by the board that change the fundamental nature of a corporation are not without recourse. Depending on the proposed action and the methods by which the actions are taken, the shareholders have several remedies available to them.

Ordinarily, shareholders do not have the ability to directly enjoin action authorized by the directors of a corporation. Shareholders enjoy many indirect remedies, including the ability to replace board members, amend the articles of incorporation, or the bylaws of the corporation. But if the board of directors is authorized to take an action and the action is taken properly, shareholders are typically limited to their dissenter's rights.

Dissenter's rights are designed to prevent a shareholder from becoming an unwilling investor in a business they do not wish to be involved in. Dissenter's rights allow a shareholder to officially object to proposed action and provide a mechanism by which they can divest themselves from further involvement with the corporation. The procedure is complicated and not available to the shareholders of all corporations.

The first step to the exercise of dissenter's rights is official board action. The board of directors must adopt a resolution recommending a fundamental change to the corporate structure. A fundamental change is a major change to the corporation which would substantially affect the rights of the shareholders. A fundamental change would be the decision to terminate the corporation, to sell all or a major portion (typically, 75% or more) of a corporation's assets, to amend the corporation's articles of incorporation, or to change the rights of a class of shares (to grant or restrict rights to dividends and other disbursements, preference or voting rights, etc.)

After the board of directors adopts a resolution recommending a fundamental change to the corporate structure, there must be notice to the shareholders and a shareholder meeting. The notice of shareholder meeting must include the time and place for the meeting, and notice must be given at least 10 days but no more than 60 days prior to the meeting. If the shareholder meeting is the annual meeting, no other information is required. If it is a special meeting of the shareholders, the notice must contain the reason for the special meeting.

A shareholder exercising dissenter's rights must then object to the proposed action by notifying the board, in writing, of their intent to object to the proposed action and exercise their dissenter's rights. The dissenting shareholder must then appear at the meeting and object (typically by voting "no" on the proposed action.)

If the action is approved by a majority of the shareholders (or more, if the bylaws require more than a majority to approve the proposed change), the objecting shareholder must then actually assert their rights by sending a demand to the board that the corporation buy back the dissenter's shares. The corporation must then make an offer to the shareholder to purchase all of their shares at the fair market value. The corporation sets the initial value and must justify the value to the shareholder, typically by providing financial information, balance sheets, and other information related to the corporation's calculation of the fair market value of the shares.

If the shareholder accepts the corporation's offer, then the transaction is completed and the shareholder is paid for their shares. If the shareholder disagrees with the corporation's valuation, the shareholder must propose a different (generally, higher) price to the corporation. The corporation

may then accept the shareholder's price and pay their demanded price, or the corporation may file a lawsuit. The court will then fix the fair market value of the shareholder's shares.

DarkStone and other investors are limited in this case to the market-out exception if they wish to sell their shares.

This process is designed to be a fair (if cumbersome) process to bring an orderly end to a shareholder's relationship with the corporation. There is, however, one major exception to this rule: if the corporation is publicly traded, the dissenters do not have dissenter's rights as just described. The "market-out" exception applies to publicly traded corporations. The remedy for a dissatisfied shareholder is to simply sell their shares for whatever market price they can get for them on the open market. The theory is that the public marketplace is the most accurate price the shareholder could possibly receive for their shares, and the transaction would be quick, easy, and cheap.

Here, the dissenting shareholders must avail themselves of the market out exception and sell their shares on the exchange if they are dissatisfied with the board's decision to approve the merger but do not wish to attempt to enjoin the sale.

DarkStone and other shareholders are not limited to selling their shares and may instead attempt to enjoin the actions of the board.

As stated above, ordinarily a shareholder cannot directly manage the corporation if the articles and bylaws provide for management by a board of directors. There are exceptions to this rule, though, if the directors are attempting an action that violates the corporation's articles of incorporation or bylaws, the shareholders may directly enjoin their activities and force a corporation to follow proper procedures.

Shareholders enjoy a great deal of indirect control over corporations. Shareholders are required to approve certain fundamental changes to the corporate structure. Here, the bylaws of the corporation require a two-thirds majority to approve a merger. The board, fearing that the shareholders will not vote in sufficient numbers to approve the merger between MedTech and GlobalHealth, unilaterally amended the bylaws to change the two-thirds majority requirement to a simple majority requirement.

The board will argue that the bylaws authorize them to change the bylaws in any way they see fit. But the bylaws are silent on the issue of whether the board can unilaterally change the bylaws to change shareholder voting requirements for fundamental transactions. It is not likely a court will find that the board had this authority. The default rules of the RMBCA (if the state in question has adopted the RMBCA--and if not, the state's own corporation's code) control by default where the

articles or bylaws are silent on a topic, or otherwise ambiguous. Since the RMBCA would require the shareholders to vote on a fundamental change to their voting rights, the court would find that the board's action to amend the bylaws to change the voting requirement was invalid.

DarkStone and the other shareholders can take several actions in response to the invalid board action. If a sufficient number of shareholders demand a special meeting, then a special meeting of the shareholders can be called. At the special meeting, the shareholders can take any one of several actions.

DarkStone should call a meeting and remove Wilson and the other two board members.

DarkStone, by itself, holds 18% of MedTech's shares. This is well in excess of the 10% required to call a special shareholder meeting. DarkStone and any other interested shareholders can call a meeting. This meeting would be a special meeting, so the notice of meeting (described above) would need to specify the purpose. The meeting could have one or many purposes: the shareholders could call a meeting to remove and replace Wilson and the other two board members that committed insider trading violations and breached their fiduciary duties, the shareholders could replace all 9 directors, the shareholders could amend the bylaws to clarify that 2/3 of them are required to approve any change to the bylaws, or simply to get the shareholders all together to yell at the board of directors for a while.

If a quorum (a majority of the votes able to be cast, unless the bylaws specifically state otherwise) appears at the shareholder meeting, then the shareholders can take any action they like as long as they have a majority vote. Here, the most obvious and probably easiest to achieve objective would be to remove Wilson and the other two board members from their roles. If those directors were removed, it is likely the remaining issues DarkStone and the other shareholders have could be easily addressed by the remaining board members. It is possible that DarkStone and the other shareholders could marshal enough support to remove the entire board and install a board who would vote down the merger.

4. The business judgment rule would not protect this board.

The business judgment rule is an extremely robust protection for the directors and officers of corporations. The duty of care that corporate directors and officers owe to the corporation and its shareholders often gives rise to apparent violations if the corporation ends up losing money on bad business decisions.

The duty of care requires directors and officers to conduct the affairs of the corporation in a way that a prudent person under the same or similar circumstances would conduct the affairs of the corporation. This requires that the directors and officers not act arbitrarily or carelessly, and must not intentionally or recklessly cause losses to the corporation or its shareholders. The business judgment rule protects directors and officers when they make decisions, as long as the decisions are made using reliable information and appear to be in the best interest of the corporation.

The business judgment rule tends to protect directors and officers when, despite their best efforts, the decisions they make harm rather than help the corporation. For example, if the board of directors votes to acquire a piece of land based on projections that a city will grow and the land will become more valuable, then the directors will be protected from liability if an unexpected economic downturn slows down the city's growth and the land loses value instead. But if the directors fail to exercise basic diligence and breach their duty of care, the business judgment rule will not protect them from liability. If the same piece of land turned out to be a toxic waste dump, and the board could have easily discovered this information by conducting a simple title search, then the board would not be shielded and the directors may be required to compensate the corporation and its shareholders for the loss.

Here, the original offer price for the merger was $75 per share. The board, without conducting any financial advisors or doing any due diligence, summarily rejected the merger. The board did not carry out the simple duty of making even a cursory evaluation of the merger and did not make any intelligent determination about whether it was beneficial for the corporation at all. The board rejected a valid offer of a $10 premium per share without any reason or justification.

The second offer price was even lower at $70 per share. The board did not seem to do any diligence on this offer either. It is highly suspicious that the board, without any other information or change in circumstances, would reject a $75 offer in favor of a lower offer. Further, at least one member of the board (Wilson) had a significant personal interest in the outcome of the merger. It is likely that she, as chairperson of the board, was able to strong-arm the rest of the board into approving the merger at the lower price without any sort of justification.

However, it does weigh heavily in the board's favor that ultimately, the merger price is still $5 per share more than the current market price of MedTech. The complaining shareholder would have a difficult time proving that the board's decision harmed him or the corporation in any way. The corporation was still ultimately acquired at higher-than-market value, but the price was not quite as high as it could have been.

Ultimately, because the board seems to have acted arbitrarily in their rejection of the $75 offer and acceptance of the $70 offer, the business judgment rule would not protect the board under these facts. The board may be liable to the corporation and its shareholders for the $5 per share difference between the first and second offer.

END OF EXAM