MONTEREY COLLEGE OF LAW

BUSINESS ORGANIZATIONS

Midterm Examination

Fall 2016

Prof. M. Cohen

INSTRUCTIONS:

There are THREE (3) questions in this examination.

You will be given three (3) hours to complete the examination.

*Answer Outline not available

1. Vista owned several odd-sized lots wedged between ranchland along the Big Sur Coast. She did not have finances to develop the odd lots of land. And in any event, the lots could not support permanent structures, because the land lacked sufficient water for basic plumbing, and the lots could not be architected with foundations necessary for buildings.

   Monterey Mini Homes, Inc. is a local corporation that builds "tiny homes," which are 200-300 square foot cottages built on a mobile wheel-based 21-foot trailer chassis. The tiny homes use propane for full service kitchens, have potable water storage for showers and other needs, use self-composting toilets and can be towed and set on just about any location. The tiny homes, moreover, come in attractive designs, many with vaulted ceilings, loft and bunk beds, tin or shingled roofs, and moveable porches.

   Vista was excited when Monterey Mini-Homes CEO Little approached her to discuss a venture. Monterey Mini-Homes would place various tiny home cottages on Vista's odd lots, for short-term vacation rentals. She readily accepted the proposal, and the two formed a limited partnership, called Vista Mini-Rentals, LP, duly registered with the Secretary of State.

   The Limited Partnership Agreement, attempting only to address circumstances that could go wrong, provided that Monterey Mini-Homes would bear 80% of any losses, and Vista would be responsible for 20% of any losses. After all, Vista was a limited partner and would not have a hand in managing the business. Accordingly she felt she should not bear more than 20% of any losses that may result from the risky venture, wholly apart from limitations to third party liability that her limited partner status afforded her.

   The partnership got off to a fast start and continued to rake in revenues, with nearly all the mini-rentals on all the Big Sur Coast odd-lots in continuous rental throughout the first year. During this period, Vista learned a lot about the tiny home business. In fact, without telling Little or anyone at Monterey Mini-Homes, Vista used her personal savings to start her own tiny home building business to compete locally and nationally against Monterey Mini-Homes.

   Likewise, Monterey Mini-Homes, Inc. CEO Little learned a lot about the Big Sur odd lot property market. In fact, during the first year managing the Vista Mini-Rentals business, Little got to know the ranchers who owned land adjacent to the Vista Mini-Rentals properties. Little began soliciting these property owners, and purchasing odd lots along the coast that the ranchers were willing to sell. Little could not say why, but he felt uneasy purchasing the lots for Monterey Mini-Homes, given its status as the General Partner in Vista Mini-Rentals LP.

Accordingly, using his personal savings, Little purchased the lots for himself, in his own name. And with his own money Little began purchasing tiny homes and placing them on his property for short term rentals in competition with the Vista Mini-Rentals LP properties.

When Vista found out about Little's competing rentals, she confronted Little and indicated she wanted out of the partnership with Monterey Mini-Homes. Little refused, indicating that he was aware Vista had formed her own mini-home building business and planned to compete against Monterey Mini-Homes. He gave her 20% of the first year's revenues and sent her on her way. She walked down Lighthouse Avenue to the first lawyer's office she could find.

a. Can Vista unilaterally end the Vista Mini-Rentals LP limited partnership without Little's consent?

b. Did Vista's conduct breach any duties owed to Monterey Mini Homes or Vista Mini-Rentals, LP?

c. Did Little's conduct breach any duties owed to Vista or Vista Mini-Rentals, LP?

d. How are Vista Mini-Rentals LP profits to be divided?

2. Professor Bizcorp liked to wrest control of public companies recently listed on the New York Stock Exchange from Sand Hill Road venture capitalists. The professor looked for new public companies that had built a business plan around ownership of intellectual property, with directors who had no demonstrated governance experience.

   With his high school buddy P. Surfinbird, now a billionaire hedge fund manager, the Professor would purchase up to 10% of the outstanding stock, and propose a "dissident" slate of experienced directors to contest the new public company founders for control of the Board.

   Waking one morning to MSNBC's Squawk Box, the Professor found his next mark, Topsoil Truffles, Inc., a venture backed company newly listed on the New York Stock Exchange. Topsoil Truffle purported to be the first company ever to patent an organic soil capable of growing coveted truffle mushrooms in any region or climate. The company's venture capitalist backers were listed as the new public company's directors. The Professor called Surfinbird, and a dissident raid was on.

   The Surfinbird Fund immediately purchased 10% of Topsoil Truffle's stock. The company's annual meeting of shareholders, where director elections are held, was scheduled to occur in 90-days. Representing the Surfinbird Fund, the Professor sent Topsoil Truffle a demand pursuant to SEC Proxy Rule 14a-8 that Topsoil Truffle carry the Surfinbird Fund's proposed dissident slate of directors on the proxy ballot.

   To campaign for the Surfinbird Fund's slate, the Professor next demanded that Topsoil Truffle provide him the shareholder list pursuant to SEC Proxy Rule 14a-7. Topsoil Truffle instantly responded, refusing to provide the shareholder information. The company confirmed, however, that it would include the Surfinbird Fund dissident director slate on the proxy ballot, and distribute any supporting materials Surfinbird Fund wished.

   The Proxy Materials that Topsoil Truffle management submitted to its shareholders included all the Surfinbird Fund supporting materials verbatim, and made the following additional responsive statement:

   "Our existing directors possess a combined forty years of management experience, and in our opinion, the directors that the Surfinbird Fund has proposed do not possess the experience needed to take a new agricultural product to market."

The statement contained a typographical error – the word "forty" should have been "fourteen" years, the actual combined management experience of the Topsoil Truffle proposed directors.

The Topsoil Truffle CEO, who reviewed and signed the company's responsive Proxy statement, was aware that one of the directors the Surfinbird Fund had proposed was the former Monsanto CEO. Monsanto is one of the largest agricultural product companies in the world, with one of the leading agricultural patent portfolios of any company on earth, including mushroom seed and soil patents and products. The Topsoil Truffle CEO was relieved the Surfinbird Fund had failed to highlight this background.

a. Was Topsoil Truffle's refusal to provide Surfinbird Fund the shareholder list proper under SEC Proxy Rule 14a-7?

b. Did the responsive statement that Topsoil Truffle management included in its Proxy Materials violate SEC Proxy Rule 14a-9?

3. Steinbeck Cannery, Inc., a privately held company, has two shareholders. The first, Del Monte Capital, LLP, is a private equity fund. The Del Monte Capital limited liability partnership invests in companies it believes have growth potential, sufficient for Del Monte Capital to sell the company at a high multiple once the company improves its performance.

   The other shareholder is Steinbeck Cannery's CEO, D. Rickett. After graduating in the top ten percent of his MBA class at UCLA, Rickett joined a consulting firm and over ten years, developed a noted reputation for improving cannery operations. Rickett then founded a cannery himself, and sold the cannery to a conglomerate.

   Given his background, Del Monte Capital recruited Rickett to become the CEO of Steinbeck Cannery. A seasoned executive, Rickett requested an equity stock investment in the company, in order to profit from any future sale that Del Monte Capital may execute. Del Monte Capital agreed to allow Rickett to purchase 15% of the authorized outstanding shares in Steinbeck Cannery.

   In addition, to ensure he could execute on his vision to improve the Company's performance, Rickett asked Del Monte Capital to vote him onto the three-member Board of Directors. Del Monte Capital agreed. Del Monte Capital appointed two of its partners to serve as Directors on the Steinbeck Cannery Board, and elected Rickett as the third Director.

   Rickett also demanded that the shareholders and the Board approve an amendment to Steinbeck Cannery's Articles of Incorporation requiring a unanimous vote of the Board of Directors for any sale of the company to a prospective purchaser. Del Monte Capital agreed, and at subsequently noticed meetings, the shareholders and the Board of Directors in turn approved the "supermajority" provision that Rickett had requested for any sale of the company.

   Finally, to align Rickett's incentives with his investment and Steinbeck Cannery's goals, Del Monte Capital proposed that Rickett accept a low annual CEO salary with a guaranteed annual bonus tied to the company's performance and growth. Rickett, confident in his ability to improve the cannery's operations, agreed.

   Rickett successfully managed Steinbeck Cannery's operations for three years, improving performance. Nevertheless, during this same period, the marketplace for canning declined year after year, because consumers turned more and more to fresh and frozen goods.

While many canneries in the country failed during this period, Steinbeck Cannery became a model of efficiency, and remained profitable. Given the marketplace, however, Del Monte Capital could not see any way to accomplish a sale in line with the high returns it expected.

Accordingly, Del Monte Capital decided to cut its losses and sell the cannery. An interested conglomerate pet food manufacturer was willing to buy the cannery for an amount that would give the shareholders a modest return on their investment, and importantly to Del Monte, avoid any loss.

At the Board of Directors meeting to discuss the sale, Rickett voiced strong opposition. Rickett expressed his view that as the canning market declined, efficient canneries would become even more rare and more valuable in the marketplace. Rickett indicated he would not vote in favor of the sale, and, citing the supermajority provision, told the majority directors he would block it. The proposed sale, therefore, never came to vote and did not occur.

At the next scheduled annual meeting of shareholders, Del Monte Capital voted to remove Rickett from the Board of Directors and elected a third Director from among Del Monte Capital's partners. The new Board further voted to terminate Rickett's employment.

As a minority shareholder in Steinbeck Cannery, does Rickett have any recourse to the Board's actions?

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1)

a. Can Vista unilaterally end the Vista Mini-Rentals LP limited partnership without Littles Consent?

A limited partnership is a partnership between two or more people who file the necessary instruments with the secretary of state's office in the state in which they plan to conduct business. A limited partnership consists of the general partner(s) and the limited partner(s). The partners usually have a partnership agreement that outlines the life of the partnership, the division of profits and losses, the type of business to be conducted, the location of the operation, the names of the general and limited partners, among other things. The partnership agreement does not need to be filed with the secretary of state. A partner may unilaterally withdraw from a partnership, otherwise known as dissociation. If this happens and the partnership agreement is silent on the matter of a partner withdrawing, or the partner is withdrawing prior to end of the term of the partnership, there are remedies available to the remaining partners. The remaining partners may buyout the partner's interest, or the partnership can be dissolved. When the partnership is dissolved the assets are sold, the remaining liabilities and debts are paid, and the remaining capital is divided between the partners.

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In the present case, the fact pattern doesn't seem to indicate the term of the limited partnership, nor does it indicate how a partner may withdraw from the partnership. This means that Vista, even though she is only the limited partner, may unilaterally withdraw from the limited partnership, and since the partnership is between herself and a corporation, it cannot function as a partnerhsip with only one member, therefore the only remedy is dissolution of the limited partnership. The business needs to be wound up, the liabilities and debts paid, and what is left gets divided between the partners.

excellent

✓

b. Did Vista's conduct breach any duties owed to Monterey Mini Homes or Vista Mini-Rentals, LP?

In a limited partnership, The limited partner owes no fiduciary duties to the partnership, or the general partner. The limited partner also is liable to third parties.

excellent

Here, Vista, the limited partner, owed no fiduciary duties to Monterey Mini Homes, Inc., the general partner, nor did Vista owe a fiduciary duty to Vista Mini-Rentals, LP, the limited partnership. Vista was free to start her own business in competition with

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Monterey Mini Homes. The fact pattern also does not indicate that the partnership agreement stated whether or not Vista could compete with Monterey Mini Homes or Vista Mini Rentals, therefore it was reasonable for Vista to believe that she was not in violation of any duties to the limited partnership, because she wasn't.

c. Did Little's conduct breach any duties owed to Vista or Vista Mini-Rentals, LP?

In a limited partnership, the general partner owes all the fiduciary duties of care, loyalty, candor, good faith/fair dealing, and to turn over information when the limited partners ask for it. The general partner may act independently for the benefit of the partnership, but the general partner has the duty to disclose that information to the limited partner, pursuant to sharing of profits and losses that occurs in partnerships. The general partner has rights of management and control of the partnership business.

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Monterey Mini-Homes, Inc. is the general partner in Vista Mini-Rentals, LP. Little, as the CEO of Monterey Mini-Homes, Inc. has a duty to act in good faith toward Vista, the limited partner, and Vista Mini-Rentals, LP. Little was not acting in good faith when he used his own savings to purchase lots and place mini homes on them without disclosing that information to Vista. The fact pattern is silent on whether or not the partners can compete with each other independently, so LIttle using his own money and purchasing plots and homes in competition with the limited partnership is only a breach of his fiduciary duty because he did not disclose what he was doing to Vista, the limited partner. Accordingly, Vista is entitled damages based on that breach, alone.

loyalty
self-dealing
Competing Against?
Corp. Oppty.

d. How are Vista Mini-Rentals, LP profits to be divided?

In parternships, generally, when the partnership agreement is silent on the division of profits and losses, the courts will follow the principle that losses follow profits, but profits never follow losses.

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In the present case, the partnership agreement for Vista Mini-Rentals, LP makes mention that the losses were to be divided as such: Monterey Mini-Rentals, Inc. would bear 80% of the losses as the general partner, and Vista would bear 20% of the losses as limited partner. The fact pattern is silent on how the partnership agreement divides the profits, so the courts would likely follow the rule that profits do not follow losses and divide the profits equally between Vista and Monterey Mini-Homes, Inc. Accordingly, Vista is

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entitled to the remaining 30% of the first year's revenues of Vista Mini-Homes, LP.

END OF EXAM

2)

a. Was Topsoil Truffle's refusal to provide Surfinbird Fund the shareholder list proper under SEC Proxy Rule 14a-7?

According to 14a-7, shareholders may request from the corporation a complete list of all the shareholders, including their names and mailing address, for the purpose of sending solicitation materials to these shareholders in advance of an upcoming shareholder vote. The company then has a choice whether to comply with this request or not. The company may send a complete shareholder list to the dissident shareholder requesting it, or the company may refuse and instead may send the dissident shareholder's solicitation materials to the shareholders directly.

good

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In this case, Topsoil Truffle's refusal to provide Surfinbird Fund the shareholder list was proper, because the company did include the Surfinbird Fund dissident director slate on the proxy ballot and submitted to its shareholders all the Surfinbird Fund supporting materials verbatim.

b. Did the responsive statement that Topsoil Truffle management included n its Proxy Materials violate SEC Proxy Rule 14a-9?

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SEC Proxy Rule 14a-9 prohibits false or misleading statements in the proxy statements sent to shareholders. In order for a statement to be considered misleading it must misrepresent a material fact, or omit material information. What is considered material is any item that a reasonable shareholder would deem to be relevant to their decision-making. Intent is not a factor in whether something is misleading or is considered a misrepresentation of fact. Whether the erroneous information is sent intentionally or by accident as an honest mistake does not make a difference, false or misleading proxy statements are actionable.

✓

great

Omnicare Test

great

Whether an opinion is actionable as a false or misleading statement of fact has recently been resolved by the Supreme Court in *Omnicare*. An opinion is actionable if there is evidence to prove that the opinion was not subjectively held by the speaker at the time they made the statement, and the opinion included an inaccurate fact or an omission of relevant facts.

Topsoil Truffle's responsive statement contained a typographical error - the word "forty" should have been "fourteen" years. Instead, the statement sent to shareholders read" Our existing directors possess a combined forty years of management experience." This typographical error was certainly a false and inaccurate statement. Whether it would be considered misleading would depend on whether the inaccurate fact could be considered material. According to the reasonable shareholder standard, if a reasonable shareholder would find the information relevant to their decision-making process, then it would be material. In this case, there is a large difference between fourteen and forty years of combined experience of a board of directors, and a reasonable shareholder may be impressed by forty years of experience and give the opinion of the board of directors more weight in their decision-making based on that information. Therefore, the information would be material, and the inaccuracy would be considered a misrepresentation of a material fact, and therefore actionable.

great

Topsoil Truffle's responsive statement also contained an actionable opinion. The proxy statement contained the following opinion "In our opinion, the directors that the Surfinbird Fund has proposed do not possess the experience needed to take a new agricultural product to market."

In this case, the Topsoil Truffle CEO who reviewed and signed the company's responsive proxy statement was aware that one of the directors the Surfinbird Fund had proposed was the former Monsanto CEO. Monsanto is one of the largest agricultural product companies in the world, so presumably the CEO of Monsanto would have the requisite background needed to take a new agricultural product to market. The fact that Topsoil Truffle CEO was relieved that the Surfinbird Fund had failed to highlight this background is evidence that he did not subjectively hold the belief in the proxy statement he signed: ""In our opinion, the directors that the Surfinbird Fund has proposed do not possess the experience needed to take a new agricultural product to market." Therefore, there is evidence that the Topsoil Truffle CEO did not subjectively hold the opinion, and the opinion contained an innacurate fact (the fact that the directors did not posess experience necessary to take a new product to market, which the CEO of Monsanto certainly did possess) and that there was an omission of the fact that one of SurfinBird's proposed directors was a former CEO of Monsanto, which was relevant to the decisionmaking process of the shareholders and therefore was a material omission.

The responsive statement that Topsoil Truffle's management included in its Proxy Materials contained a false or missleading statement of fact as well as an inaccurate

opinion (which as not subjectively held by the management) which omitted a material fact that was known to the management - for these reasons the Topsoil Truffle's responsive statement violated SEC Proxy Rule 14a-9.

END OF EXAM

Blue Book

NAME

SUBJECT BUS org - Fall 2016

INSTRUCTOR Cohen

EXAM SEAT NO. SECTION Q3 B1of1

DATE Dec 6, 2016 GRADE

Question 3

Stein Beck Cannery, Inc.

Because Steinbeck Cannery, Inc is a corporation, corporate law applies. A corporation can either be a public corporation or close corporation. A public corporation has may stockholders and its stock is publically traded. A closely held corporation has few shareholders, typically less than thirty, and the stock is not publically traded. The company is typically local or family owned, and conducting a business that is not marketable on the public stock exchange.

Here, SteinBeck has two shareholders: Del Monte Capital, LLP and Doc Ricketts. Therefore, Steinbeck has few shareholders and the stock is not publically traded, ~~because document~~ Steinbeck is then a close corporation. ✓

In close corporations, rules and protections for minority shareholders differ, because the company is run differently than a public company. ✓

Here, Del Monte is the majority shareholder and Ricketts is the minority. Therefore, if certain circumstances are met, Ricketts is entitled to protection, because he owns only 15% of stock.

Because closely held corporations have no market for the shares, then when majority shareholders engage in oppressive conduct against the minority, it results in a freeze out and the minority may have some remedies.

Rickett will argue Del Monte's conduct was oppressive. They failed to follow through on the agreed upon sale, they removed him from the Board of Directors (BOD). and then fired him. Because closely held corporation stock cannot be sold, Rickett was then stuck.

Therefore, ~~[illegible]~~ Rickett will argue this was a freeze-out.

First, Rickett would need to show the conduct went against his reasonable expectation of being a minority shareholder when he became a shareholder.

Typically, shareholders in close corporations are involved in the management and day to day operations, and are typically a member of the Board. Also, the min. shareholder typically relies on the salary and dividends for profit and livlihood, since there are no pay outs from trading stock.

excellent.

Rickett would argue when he obtained the stock, he expected to run the company as CEO and increase the corp's performance such that they could sell the corp. to a conglomerate to then make a profit. Because of Ricketts educational and prossional experience, Del Monte knew this was Ricketts expectation at the time of the transaction. Ricketts reputation is improving cannery ~~option~~ operations and then selling. The facts indicate Del Monte knew this and recruited Rickett because of it. Further, because Rickett added the amendment of a sale of the corp, this also shows the expectation was to sell.

Then, the agreement stated Rickett had a low salary with a bonus tied to performance and growth. Therefore, Rickett expected to have a large managment role in the company such that he could increase growth and obtain a large bonus. Therefore, by being fired from his CEO position, he is then unable to manage the company and receive the bonuses.

Del Monte would argue that Rickett is not a typical minority stockholder because he does not rely on

salary and dividends for his livlihood. Ricketh founded a cannery himself and just sold it, so he likely has enough money to support himself. Also, he is a part of a consulting firm and has a good reputation in his professional endeavors. Therefore, he did not rely on the CEO position as his means for livlihood and thus getting removed did not deny any reasonable expectation.

However, despite his good reputation and successful career, Ricketh could argue that ~~to his main~~ e pris past sales or jobs have no bearing. At the time of the transaction, he was ~~suppos~~ expecting to improve the company function for a future sale, to then recieve his benefits in salary and bonuses. Del Monte knew this, and went against these expectations.

great analysis.

Further, courts have stated CEOs should be looked at especially. Ricketh, as CEO, worked for many years successfully improving corporate performance and managing the company. Even when the market for canning declined, Steinbeck still remained efficient and profitable because of Ricketts efforts. The courts will consider these facts as highly

important when determining whether a close corporation froze out a CEO.

Next, Del Monte would have to show it acted for the best interest of the corporation.

Del Monte's argument would be the market was not there, so a sale was unlikely. The biggest factor in corporations is maximizing profits. Del Monte believed they would not receive the high returns expected. They would say Rickett was too cocky and believed he could make a sale ~~off~~ and receive the high sale price originally intended. Therefore, the best thing for the corporation was to ~~not~~ sell, get rid of Rickett, and ~~keep the corporation until the market for coffee improved~~. avoid loss.

Rickett would argue there was a less injurious alternative available. There was a willing buyer which could have given them a modest return and avoided loss, ~~Rickett would have received~~ and ~~his expectations~~, not been out of company however, the sale would not have maximized profit. Rickett argued that the corp would be more rare, and more valuable, meaning it

would eventually get a high sale price. Also, this would result in Ricketts keeping his job so he could raise the corporation's value.

The BOD would argue Ricketts could not amend the Articles for urgency and then try to block the vote.

Ricketts would argue because they voted and properly noticed the meeting and held it for a proper purpose, then the amending is valid.

The majority shareholders cannot infringe on the minority shareholders ability to vote and ensure their shares are voted how they want.

Because there were alternatives with keeping the company to further thrive and grow, then Ricketts would argue a freeze out occurred.

The court would likely conclude that the BOD conduct did violate Ricketts reasonable expectations that the corporation was aware of. Though they did act in the best interest, they believed, but there were less injurious methods.

Therefore, a freeze out occured and Ricketts would be protected ~~[illegible]~~

good paper:
① could more clearly delineate ⓐ wilkes test (leg. biz interests v. less injurious alternative) from ⓑ "oppression" reasonable expectation test.
② discuss mandatory buy-out remedy!