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Exam No. _____

**Business Associations # 520
Fall Semester 2005**

**UNM School of Law
Final Examination
Three Credits**

**Professor Paley
Monday, Dec. 12, 2005
9:00 a.m.--140 mins.**

**Examination Format
Essay Answers**

1. **Laptop** computer users: Start the Securexam program entering your examination number, course name, professor's name, & date of examination. Click "proceed" to enter the program. Type START in the next window that is displayed but do NOT press the enter key until the proctor says to begin the exam. **IMPORTANT: Make sure you answer in no more than the number of lines indicated for each question on the exam.**

2. **Hand-written exams—DO NOT USE BLUEBOOKS. Write your answers directly on the lines provided on the exam itself.**

On the top of the exam, clearly write your exam number. Do not put your names on the exam.

A five-minute warning will be given prior to the conclusion of the examination. When time is called, stop immediately. If you are handwriting, lay down your pen & close bluebook immediately. If using a laptop, save & exit the program.

Go to the exam check-in table at the conclusion of the exam & fill out an examination receipt.

Professor's Instructions Follow

EXAM # _____

The University of New Mexico School of Law

Business Associations
Professor Stewart Paley
Course 520
Fall 2005

FINAL EXAMINATION

This is a two hour & 20 minute exam.

GENERAL INSTRUCTIONS

1. Print your student identifier at the top of this page.
2. The exam is contained on pages 1 to 16. **Make sure that your copy is not missing any pages.**
3. **PERMITTED MATERIALS:** You may consult the course materials, any handouts passed out in class, our statutory supplement, casebook, and any notes or outlines which you prepared or which you participated in preparing.
4. The exam consists of 12 short answer questions, as well as an extra-credit question. **Read each question carefully.**
5. **SPACE LIMITATIONS:**

UNLESS YOU ARE USING A COMPUTER, ALL ANSWERS SHOULD BE WRITTEN DIRECTLY ON THE LINES PROVIDED IN THIS EXAM, NOT IN A BLUE BOOK.

IF YOU ARE USING A COMPUTER, ALL ANSWERS SHOULD BE TYPED IN THE NUMBER OF LINES INDICATED FOR EACH QUESTION.

Remember, you do not need to use all of the available space.

6. **LAW TO BE APPLIED:**

The Restatement and Acts we discussed in class, including the UPA, other model acts where appropriate, the Restatement of Agency, as well as any common law contracts concepts we discussed in class.

YOU WILL EARN A FEW POINTS FOR CITING TO RELEVANT PORTIONS OF THE UPA, RESTATEMENT, OR OTHER APPLICABLE LAW WHENEVER POSSIBLE.

7. **Write legibly and give all answers concisely.** Discuss all relevant issues in each fact situation. Even if you believe that one issue is dispositive, discuss all other relevant issues anyway.
8. Questions on this exam will inevitably have fewer facts than would be optimal in predicting legal rights. When more information is required, explicitly state your assumptions and indicate why such assumptions are necessary but do not assume any fact inconsistent with those stated in the given fact situation. If the question asks you to suggest additional facts to improve the quality of your prediction, please be comprehensive and imaginative.
9. The suggested time for each question is noted. The suggested time for the exam questions is **120 MINUTES**. The suggested time for each question reflects the relative weight that will be assigned to that question. You have been given an **extra 20 minutes** to peruse the exam and budget your time (for a total of 140 minutes).

CAUTION! The questions (and lines for answering the questions) sometimes continue on the following page.

GOOD LUCK AND BUDGET YOUR TIME.

1. (5 minutes) In forming any business entity, what are the four (or five, depending on how you categorize them) most important issues that always need to be addressed? Briefly explain. **[5 lines]**

2. (10 minutes) Fred Hart finds some undeveloped land for sale for \$300,000 (which is the fair market value). Through his shrewd business acumen, he successfully negotiates a below market purchase price of \$225,000 and purchases the property. A few weeks later, NatCorp, a closely-held corporation wholly owned and controlled by Nathalie, hires Fred to find a parcel of undeveloped land for it. A few days later, after scouting other available properties (all of which are unsuitable), Fred realizes his land is a perfect fit. Fred shows Nathalie his land, but doesn't disclose that he owns it. Nathalie agrees that the land is perfect and asks about the price. Fred tells Nathalie that the land can be bought for \$275,000 (which is still below the market value for this size and type of property). NatCorp then buys the land for \$275,000.

One month later, Nathalie and NatCorp each sue Fred. Can either and/or both recover? Explain why or why not? **[6 lines]**

3. (15 minutes for A – C) A friend's daughter, Carmen (who's 18 years old), housesits while we're away. We tell Carmen she should make herself at home, take care of things, and that our primary concern is the well-being of our pets, Zeke-the-Dog and Ms. Kitty-the-Cat. We also tell Carmen that we just washed Zeke so he'll be cute and cuddly for her. We remind Carmen that she needs to take Zeke to our regular vet for his check-up. Before we leave, I give Carmen our copy of the vet's check-up reminder and write at the bottom: "Carmen's caring for our pets, Zeke & Ms. Kitty. Please be nice to Carmen & make sure she gets whatever the critters need. Thanx, SP"

A few days later, on her way to the vet with Zeke, Carmen sees the neighborhood stray ("Houndog") wandering in the street. Being the good kid that she is, Carmen picks up Houndog. Carmen brings Zeke to the vet's, and then remembers that Houndog isn't looking too sharp these days, so brings him in too and has check-ups done on both mutts. While waiting around, Carmen sees a special on dog grooming, so also has them both cleaned up.

Back home the next day, Zeke-the-now-cleaner-Dog, greets two visitors at our house. The first visitor is a sprinkler repairwoman who noticed a leak in our yard. The second visitor is a high-speed Internet access man who noticed no cable to our house. They each speak with Carmen, tell her their concerns (a leaky water system on one hand, and a "stone-age" home not at all suited for a professor/teacher couple on the other), and Carmen authorizes them to do the repair and installation work.

To her credit, Carmen told the vet, sprinkler woman, and internet guy that she was house-sitting while we're away for the week and even showed them my hand-written note on the vet's reminder so they'd know who she was. We're now faced with the following bills and want to know whether or not we're responsible and why. Please advise.

A. The vet's bill for \$200 for check-ups of Zeke and Houndog (\$100 each).
[5 lines]

B. The vet's bill for \$150 for the dogs' grooming (\$75 each).
[4 lines]

C. The sprinkler repair bill of \$250 and the Internet access bill of \$175.
[6 lines]

4. (5 minutes) In the *Smith v. Van Gorkom* case, if Jay Pritzker's \$55 per share bid for the company had been outbid by \$2 a share by a competing bidder (so that the successful bid was \$57 a share by someone other than Jay Pritzker), how much money (if any) would Pritzker have made as the losing bidder and why? **[4 lines]**

5. (15 minutes for A – B) Jenny Moore, Fred Hart, and Ted O have come up with what they think is a great idea. They agree to start working together on a venture they call "Coffee and Cases." Basically, they'll give legal seminars to busy Albuquerque attorneys over coffee and breakfast.

To get things going, they each put in \$50,000 to purchase office supplies, advertising, books, legal journals, etc. They agree that as long as they're active in Coffee and Cases, they won't work for any competitor, and that they'll put their best efforts into the business for at least two years (to get it off the ground) and then so long as "we're in business together." Of course, being the typical lawyers dealing with their own affairs, they write none of this down.

During the first year, all goes well. Then Fred decides he wants out, tells this to Jenny and Ted, and also says that he wants the business assets sold so he can get some cash. Jenny and Ted are very surprised, wish Fred wouldn't leave, definitely don't want to sell Coffee and Cases and react in extremely different ways. Jenny immediately goes to the Albuquerque Journal and the local legal newspaper/bulletin and places advertisements indicating that Fred is leaving Coffee and Cases, but that "We'll Continue to Tastefully Teach You!" The ad's cost \$500 and are due to run next week. Ted, on the other hand, sees an opportunity for expansion, and immediately signs a 10-year lease for office space for the business.

Despite their differences, the three realize that going to court is not the answer. Rather, they come to you and agree to be bound by your resolution of the following issues. Please advise them and explain your reasons.

- A. Does Fred have the right and power to dissolve the business and cause the sale of the business assets? Why or why not? **[6 lines]**

B. Who is liable for payment of the advertising costs and lease obligations?
[6 lines]

(15 minutes for C – E) Now assume that after talking with you, Jenny, Ted and Fred somehow come to an amicable resolution that allowed Fred to leave the business, while Jenny and Ted continued it. Just after Fred left (and partly because of his departure), Coffee and Cases needed some ready cash. Jenny and Ted mentioned this to Nathalie, told her how they'd agreed to run the business, and invited her to join. Nathalie jumped at the chance to break bagels with Albuquerque's hotshot lawyers and invested \$50,000 into the business. She immediately began doing breakfast seminars and, although Jenny and Ted repeatedly invited Nathalie to do so, Nathalie really didn't participate in business decisions. In fact, Nathalie's been heard to say, "I'm happy being in this for the brunch and the books!"

Things go along merrily for a few years, but then Nathalie decides she also wants out. Jenny and Ted are surprised, not only because Nathalie seemed happy, but also because just last month the three agreed to a six month TV advertising contract (for which \$30,000 is still owed). It seems that Nat, together with some lawyers she knows from court and others she met during breakfasts, want to form a new seminar business called "Appetizers and Appeals" that teach lawyers during swanky cocktail hours. Because she needs some cash for the new business, Nat wants Coffee and Cases sold and the proceeds distributed.

As before, and although there are more hard feelings this time around, the three come to you to resolve their issues. Once again, please advise them on the following questions and explain your reasons.

C. Does Nathalie have the right and power to dissolve the business and force the sale of the assets of Coffee and Cases?
[6 lines]

D. Who is liable for payment of the TV advertising and office lease obligations? **[6 lines]**

E. Finally, it seems that the bills for the advertisements that Jenny ran long ago when Fred was leaving were never paid. Who's responsible for these?
[4 lines]

6. (5 minutes) Think about a director's various duties owed to a corporation. In one or two sentences, draft a simple piece of legislation that would ensure directors are fully aware of their responsibilities owed to the corporation. [We're not looking for a penalty statute here, rather a preventative one that ensures directors are aware of their duties]
[5 lines]

[Next Page]

7. (10 minutes) Lumex, a public company in Washington State, makes wooden lawn furniture in an environmentally friendly manner. Recently, Lumex has been watching its profit margin shrink as consumers have become more price-conscious. Another company that is in the highly profitable and legal business of timber clear-cutting has approached Lumex. The process of clear-cutting is well known to be environmentally damaging and much of the damage can't be reversed due to erosion, species elimination, and other issues. Accepting the clear-cutter's offer would produce a profit for shareholders of Lumex and not doing so will leave Lumex in a somewhat precarious financial position.

Assume you are corporate counsel to Lumex' board of directors and they have asked you for advice on how to proceed. What difference does it make whether Washington State has enacted the following statute? Please advise your directors.

Standard of Conduct.

Standard; Liability. A director and/or corporate officer shall discharge the duties of the position of director (i) in good faith, (ii) in a manner the director and/or corporate officer reasonably believes to be in the best interests of the corporation, but not at the expense of the environment, human rights, the public health or safety, the communities in which the corporation operates or the dignity of its employees and (iii) with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable to the corporation or limited liability corporation or its shareholders by reason of being or having been a director and/or corporate officer of the corporation.

[8 lines]

8. (10 minutes) A while ago, a friend of ours went to work for a closely-held corporation. She was a mid-level manager, someone who bought inventory, lined up and priced jobs, and had a few people working under her to do installation and service work. She worked hard and was paid well, but by no means extravagantly. Recently, after working for the corporation for a couple years, she was given the opportunity to buy about 10% of the outstanding shares, which she did for \$10,000. She has never been an officer or director of the business.

Last week, she learned that a creditor had successfully sued the corporation and that the very large judgment far exceeded the corporate assets. She also learned that the creditor is now going to pursue its rights against shareholders under something called "piercing the corporate veil." From what she heard, the majority shareholder (who is also a director and officer of the company) basically ran the business as he would run a "lemonade stand" in front of his house (meaning he didn't really keep books and records, co-mingled funds and assets, took money out of the business whenever possible, etc.,). She just got a call from the creditor's attorney saying they'd release her from all "piercing" type claims if she paid \$20,000 cash. She doesn't want to needlessly part with \$20,000, but at the same time has about \$70,000 in savings and about \$50,000 of equity in her house to worry about.

From what she's told us, and what you know about piercing the corporate veil, what will you advise her to do and why? **[6 lines]**

9. (5 minutes) Fred Hart's been busy again. This time, Fred buys some antique farming equipment for \$50,000. Fred then forms a sub-S corporation and gives the corporation \$100,000 in exchange for all of its stock. Fred sells the equipment to the corporation for \$100,000, discloses his profit to the corporation's board of directors (which are Fred and his buddies), and the board approves the sale. A few days later, Fred sells all of the stock in the corporation to Nathalie. Nathalie replaces the board of directors with herself and her friends, and shortly after finds out about Fred's antics.

Nat and the corporation each sue Fred. Can either and/or both recover? Why or why not? **[5 lines]**

10. (5 minutes) In a few sentences, briefly explain why and what type(s) of conduct are not typically covered by Director and Officer "error and omission" insurance and indemnification. **[5 lines]**

11. (15 minutes for A & B) Ms. R E Mogul has been very successful in the real estate market for several years. In fact, she's almost been too successful because now whenever her name is mentioned in connection with a property, she finds that the prices of potential purchases rise dramatically. One day, Andy approaches Ms. Mogul and tells her about a property he's found. They talk it over, she looks at Andy's research and, although they've never done business before, Mogul asks Andy to try to buy the property for her as long as Andy can get it for under \$300,000. Andy's delighted. Although Mogul isn't willing to pay him anything for his work, Andy feels this is a great way to get in good with a real estate tycoon.

A few days later, Andy meets with the Seller and tells the Seller that he's interested in the property. The Seller initially wants \$600,000 for the property, but after they talk, haggle, and joke a bit, Andy succeeds in getting a drastically reduced price of \$325,000. Andy's ecstatic because he's just negotiated an almost 50% reduction in the sale price, something rarely heard of in this tight real estate market.

Cynics sometimes say "No good deed goes unpunished" and in this situation that seems to be the case. As Andy is leaving the Seller's place, he collides into a neighbor's car. On top of that, when Andy later reports his success to Mogul, Mogul's not at all pleased. For some reason (maybe news of the car accident didn't help), Ms. Mogul simply tells Andy he's on his own with "this whole fiasco" and shows Andy to the door.

Remembering you as a bright, hard-working, honest attorney, Andy now seeks your counsel. It seems the Seller has been demanding that Andy pay the purchase price, and the owner of the car Andy hit has been demanding that Andy pay for the auto damages. He has asks you to answer the questions below and briefly explain the law to him. [If relevant, you should assume that all of these facts are now public and that there's no problem with the Statute of Frauds for this situation.]

A. First, is Andy liable to anyone? **[6 lines]**

[Continued]

B. Second, is Ms. Mogul liable to Andy or anyone else? **[6 lines]**

12. (5 minutes) In a few sentences, and in connection with the corporate veil, describe what a creditor of a corporation accomplishes through "reverse piercing." **[5 lines]**

Extra time? Extra-credit—Think back to the case. In *Francis*, the court held Mrs. Pritchard in breach of duty of care as a director. If Mrs. Pritchard's actions are subject to piercing the corporate veil theory, what would be the result?
[7 lines]

Have a word