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**520 – Business Associations I  
Fall Semester 2006**

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

**Professor Gerding  
Saturday, December 9 2006  
Thursday, December 14, 2006  
9:00-12:00 p.m.(3 hours)**

**Examination Format  
Essay Answers & Multiple Choice/True False Questions**

**MAKE SURE TO TYPE OR WRITE THE EXAM QUESTION NUMBER AND THEN ANSWER THE QUESTION.**

1. **Laptop** computer users: Start the Secureexam 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.

2. **Bluebooks** for writing: write on every-other line and only on the front page of each sheet. On the front of bluebook record the class name, professor's name, date of exam, and your examination number. Make sure to number each bluebook in order. **DO NOT WRITE YOUR NAME ON BLUEBOOKS.**

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**

There are 3 parts. The first part consists of 28 true or false, multiple choice and fill in the blank questions worth 20% of the exam grade. The second part consists of 5 short answer essay questions where I would expect concise answers of 1 to 3 paragraphs. The second part is worth 40% of the overall exam grade. The third part consists of 2 longer essay questions and is also worth 40% of the overall exam grade.

As a benchmark, I suggest you spend 40 minutes on Part I (the multiple choice/true false/fill in the blanks), 70 minutes on Part II (the short essays), and 70 minutes on Part III (the longer essays).

You may and should use your statutory supplement for this exam, but may not use any other materials.

Please read each question carefully and think before you write.

## Part II

### Short Essays (One to three paragraph answers should be sufficient.) (Collectively worth 40% of the exam grade)

29. What are the principal terms of a preferred share? Why would someone invest in a preferred share as opposed to a common share?
30. Your friend, Fredo Corazon, is starting his own biotechnology company here in Albuquerque together with three friends. He expects the company to grow exponentially in the next five years, become the next Google and either sell shares to the public or otherwise attract many new investors. He comes to you with some basic questions about which form of entity he should choose. He knows a little bit about the law you just studied and is convinced that limited liability companies are the way to go because they offer him so much flexibility (as well as limited liability and partnership tax treatment).

You tell him that “with great flexibility, comes great responsibility.”

He snorts and says, “Yeah, I heard that line before. I’ll carefully read the limited liability company operating agreement, make sure that our lawyers carefully tailor it so it meets the specific needs of me and my three co-investors, and make sure that all four of us understand and agree to what is in there. But are there any **other downsides** to an LLC besides ‘you need to understand the operating agreement’?”

Given Fredo’s goals, what other downsides can you think of with choosing an LLC compared to a corporation?

31. Based solely on the facts in Question 2 in the multiple choice section, assume that just after entering into the partnership agreement Bruce enters into a loan agreement to borrow money for the partnership operations from Constitution Bank and Trust. If the partnership dissolves within the first years, the loan will become immediately due and payable in the amount of \$50,000

Ashton and Demi are furious with Bruce for entering into this agreement without seeking their approval first and vote to dissolve the partnership.

Assume that there are no other potential liabilities of the partnership and the partnership never has not had any profits or losses to date.

What will each partner receive on dissolution? Your answer should briefly cite and interpret the language of the Uniform Partnership Act (1997) that you find helpful. (The following provisions of the Uniform Partnership Act (1997), among others, may be helpful for your answer: Sections 401, 801 and 807). Your answer should include dollar amounts.

32. Describe three defense mechanisms you found in the Scavenger Hunt that public companies use to fight off hostile takeovers, and discuss very briefly how they function.

33. You represent SKA A.B., a corporation organized under the laws of Sweden that manufactures kayaks, canoes and other “personal adventure watercraft.” Zebulon has incorporated a small subsidiary, ZebReb, Inc. under the laws of Delaware. SKA wants to use ZebReb as a kayak outfitter in New Mexico; the subsidiary will lead expeditions of adventure tourists down dangerous whitewater rapids in the state.

SKA is extremely concerned about veil piercing given the high risk to people who go down waterfalls in small plastic boats. They hired one lawyer who told them simply, “just observe corporate formalities, Swedish dudes!” SKA is trying to decipher what does “observing corporate formalities” really mean. Please explain this concept to them and provide examples of some of the most important “corporate formalities” that should be observed.

### Part III

#### Longer Essays (Suggested answer length is two to three pages per question) (Collectively worth 40% of the exam grade)

34. Recall the facts in Question 30. A year has passed. Fredo again comes to you for advice. He and his co-investors ultimately chose an LLC, but now they are mostly tired of running the day to day affairs of the company and are in over their heads trying to manage a company that is growing so quickly and will soon have an initial public offering (*i.e.* a portion of the company's stock will be sold to the public).

Fredo and his initial co-investors want to change the form of the entity to a Delaware corporation and bring in more experienced management to help run the day to day affairs of the corporation. All four of the co-investors will retain significant chunks of the company's stock and plan to continue to have significant shareholdings even after the initial public offering. In fact, Fredo will hold 87% of the Class B stock of the corporation, with the corporation having a similar capital structure (*i.e.* the same kinds of stock with the same terms) as Google.

Of the initial co-investors, only Fredo will retain a position in management – as the Chief Operating Officer and Chief Technology Officer. Fredo will also be Chairman of the Board.

- a. Fredo asks your advice in structuring a *process* by which the board of directors will set both the compensation and indemnification of executives and directors.
    - i. Please make specific recommendations.
    - ii. One co-investor recommends that the specific terms for executive compensation be placed in the bylaws. What do you think of this idea?
  - b. In terms of indemnification, Fredo doesn't understand why some of his employees are telling him that shareholders may grumble about indemnification. Please explain the possible concern to Fredo. What counter arguments can Fredo make to explain how indemnification may be in the shareholders' interest?
  - c. Fredo is now independently wealthy, and does not need or want a big salary for his role as director and officer. He plans on making most of his money from the corporation through his shareholdings. As such he wants to make sure that the management is acting in the best interests of shareholders. He also wants to build a long term future for the company and to create a "socially responsible company."
  - d. He wants to compensate management to create the right incentives for them. Do you have any nuanced ideas for Fredo in terms of the *substantive* compensation structure for executives?
35. What other things could hold management accountable to shareholders? Please make additional recommendations on what other devices Fredo could use, other than compensation, to make sure management is acting in the interests of shareholders and in a socially responsible manner. Please include in your discussion any tradeoffs or costs involved in your recommendations.

**END OF THE EXAM.**

**Celebrate responsibly.**