Institution **Harvard Law School**
Course **S15 Clark - Corporations**

Event **NA**

Exam Mode **OPEN LAPTOP**

Exam ID **789160**

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**1941**	**9263**	**11178**
Section 2	**790**	**3729**	**4514**
Section 3	**855**	**4131**	**4979**
Section 4	**552**	**2507**	**3055**
Total	**4138**	**19630**	**23726**

Answer-to-Question-_1_

Claims against Crammer:

Crammer looks like he is going to be in some big trouble here (not surprising). He is vulnerable to a 10b-5/10b5-1 insider trading claim, brought by either private parties (SEA §20A) or the SEC (SEA §21A). He is also vulnerable to tippee and tipper liability and possibly under the misappropriation theory, as well as a Reg FD claim. There are also possible claims under Rule 14e-3 for trading on inside information about Tender Offers, an SEA § 16(b) "Short Swing profits" claim and a breach of his Duty of Loyalty.

10b-5/10b5-1:

As a member the the SFC board, Crammer has a duty to disclose or abstain from trading when he hold material non-public information. In order to hold him liable it would need to be showing that he possessed material non-public information, traded on the basis of it and made profits or avoided losses. Here, the facts indicate that he had non-public info, notmanagement even the "top management" or "the other directors" knew about the importance of the toriander seeds (though buying non-security assets does not fall under 10b-5 or insider trading but this will be significant later) and SFC was "surprised" by WFC's TO in march. Both of these pieces of information were likely material because there was a substantial likelihood that a reasonable investor would consider them to significantly alter the total mix of info available when making an investment decision (*Basic*). Mergers are high significant events in a corp's life (*Basic*)

and so this by itself would likely make this information material. There is no question that Crammer traded on the information and being aware of the information when trading creates a presumption of "trading on the basis of" (10b5-1) unless there was some preset plan or contract which there wasn't here. He also made a substantial profit (2m total, we will look at whether we need to divide his old holding from his new ones) in trading in these securities.

This claim could either be brought by the SEC under §21A, in which they could seek treble damages. It could also be brought by a contemporaneous trader (traded same day as Crammer but in the opposite direction)(§20A - this could include SFC if they traded the same day, we will talk about derivative suits below). They would be able to get up to the full amount of his profits if Crammers profits distributed pro rata among the plaintiffs. This take would be limited by any disgorgment that the SEC requires (so if there is an SEC action going forward there is little incentive for private parties to get involved...certainly takes all the fun out of § 20A).

Tippee/Tipper:

It is possible to get Crammer for Tippee liability, jointly and severally with Deb as the tipper. It might also be possible, if we discovered that Deb traded on the information that Crammer gave her to get Crammer as a tipper, joint and severally with Deb as the tippee. This is an unlikely claim because the tippee receives the fiduciary duties of the tipper (in this case to WFC) and Crammer did not trade in WFC securities. If Deb traded in SFC securities we might be able to go the other way as mentioned (she would have

Crammer's fiduciary duties to SFC). The test would be, did the insider get any benefit (*Dirks*) and as this was a tip to a girlfriend it is possible that the court would consider this a benefit to Crammer but we would need more information on this. There is no question that both Deb and Crammer would have understood that this tipping was a breach of their respective fiduciary duties.

Misappropriation Theory:

It would also be possible to get Crammer on the misappropriation theory of insider trading but the *O'Hagan* theory of fiduciary duty to the source and the addition of 10b5-2 were designed to catch non-insiders. It may be a mis-use of this theory of liability and overkill. All the same, when non-public material information is given to someone who agrees to keep that info in confidence or where there is patter or practice of keeping info confidential (as with lovers perhaps) or where the info came from a family member (is girlfriend close enough? Tough one) the trader can be held liable. As I mentioned above, it is probably unnecessary as Crammer is an insider.

Reg FD:

14e-3:

This rule prohibits insider trading in connection with a tender offer. It is possible that Crammer could argue that he traded in the SFC securities because of the worth of the

seed, which would increase the value of the SFC itself and not because of the imminent tender offer from WFC but this would sink him on other claims and it wouldn't save him here. WFC was "seriously planning a TO for SFC" (likely enough for substantial steps), Crammer was in possession of the info thanks to Deb, and he knew (be if he didn't know he certainly had reason to know) as a director that this information was non-public because SFC was "surprised" by WFC's TO. He also knew that this information was acquired indirectly from the issuer via Deb who had a fiduciary duty to WFC.

As above, these claims could be brought under the private right of action or by the SEC with the same remedies available.

SEA § 16(b):

§16(b) is a strict, bright-line, prophylactic rule that requires the disgorgement of any profits made by any Officer, Director, or beneficial owner of securities in a corporation for the sale and purchase (in either order) of equity securities in a 6 month window. This claim can either be brought by the SEC or derivatively by the corporation.

~Derivative Suits~

Any SH would would like to being this claim would need to either make a demand (an be estopped from claiming futility (*Grimes*)) or proceed without a demand an claim that the demand was futile. If the SH makes the demand and it is accepted then the corp can either move forward with the claim itself or allow the SH to go forward. The former is almost ALWAYS the case so demands are usually not made. If the demand is rejected

---

she would have to claim wrongful refusal by alleging particularized facts raisin reasonable doubt that the board acted independently or in due care. There is no discover, just the "tools at hand" like relevant corp records (DGCL §220(b)). The 16(a) filing with the SEC would help in this case.

If no demand is made, much like wrongful refusal, the SH will have the burden to show futility using the "tools at hand" and alleging particularized facts showing that the board had financial or familial interests in the transaction, that the board was dominated by interested party (*Grimes*) or that the underlying transaction was not a product of valid business judgment (board was minimally informed/there was inadequate process). If either the ct finds futility or wrongful refusal the board can form a special litigation committee and appoint independent directors to it to look that the derivative claim. If they accept the claim it is much like it was accepted in the first place but if they reject it the DE cts use the two step Zapata test. They look first at the procedure, the SLC members are truly independent (not on the board at time of wrong doing or no familial/financial interest) and their investigation was adequate. If that works out, unlike in NY, the ct can substitute its own business judgment for that of the SLC and make a substantive inquiry of the dismissal. The ct rarely overturns a dismissal but it gives incredible incentives for the SLC to go through mountains of process.

~16(b)~

In either the derivative claim or one brought by the SEC, the plaintiff need only show that the defendant was a Director, officer or beneficial owner and that the purchase and sale occurred within the 6 month window. The Disgorgment is maximized by pairing

the lowest purchase and highest sale. Here, the old stocks would not be liable but the profits for the 20k shares that were purchased on Feb. 17 would certainly be disgorged.

Duty of Loyalty - Interested Director Transaction**/Corp Opportunity Doctrine:**

Perhaps the most interesting claim, a derivative suit could be brought for Crammers breach of fiduciary duty of loyalty to SFC. When he purchased $300k in Toriander Seed it was an interested transaction. When he was trying to maximize his own profit he both usurped a corporate opportunity and had a conflict of interest, and possibly acted in bad faith (wasn't trying to maximize value for the SHs).

~Corp Opportunity~

For the usurpation of the corporate opportunity, there is a balancing test. (1) Could the corp financially take advantage of the opportunity (here there is no problem, they owned the seeds), (2) was it in the corp line of business (this too is definite yes, they were already using this product and selling it to pharma corps would have been in the line of business), (3) Did the corp have reasonable expectancy (sure, selling your own assets at a huge profit if the opportunity comes along would be something the corp would expect), and (4) the defendant taking the opportunity will bring his interest in conflict with that of the corps interest (*eBay*) (yes, maximizing personal profits v. maximizing SH value). This looks like an open and shut case but there is the possibility of a safe harbor if they board was notified of Crammer taking the opportunity (*Broz*) as there was here, but we will talk about ratification below.

~Interested Director~

Where a director is on both sides of a transaction or the director has a conflict of interest the transaction will be reviewed under intrinsic fairness and the director will have to show good faith and terms as good as there would have been in a arm's length transaction. Here there was certainly a conflict of interest as mentioned above. Because of the information about the worth of the Toriander seeds were not yet on the market, it is possible that the terms were as good as they would have been in an arms length transaction at that time but there was very likely bad faith. Crammer knew about the worth of the seeds and he purchased them BECAUSE of the knowledge.

~Bad Faith~

There is bad faith when there is conduct motivated by an actual intent to do harm (subjective) or an intentional dereliction of duty/conscious disregard for one's responsibilities. (*Disney*). Here there may or may not have been actual intent to do harm but there was certainly an intentional dereliction of duties. As a director Crammer would know that he had a duty of loyalty to the corp and he purchased huge amounts of assets from the corp without telling them the real worth. This doesn't look like fair dealing and the cts will not like it. He acted for himself and sought ratification of the board showing how two-faced he was. He acted for his own benefit and did so at surreptitiously at the expense of the corp.

~Ratification~

The real wrench here is that there was a board ratification. He, as *Broz* suggests,

disclosed his interest to the board in buying the corp and an independent committee approved the purchase. But they were not fully informed and Crammer knew it. It may be an issue of substance over form but this ratification cannot be expected to cure the ills of the self-interest here because of the bad faith. As such, the profits, all 700k of them should be divested to the SFC.

Answer-to-Question-_2_

Unocal:

Defensive measures for unwanted Takeover attempts are reviewed under the conditional BJR standard of Unocal because of the "omnipresent specter" of boards acting in their own interests. Such defenses must have fiduciary outs (*omnicare*) and if they are a poison pill almost always must be redeemable (Moran). Defenses are also considered holistically under the Unocal test (*unitrin*).

The first inquiry of unocal is if the board had the authority to bring these defenses into being. To determine this we look to statute, articles of incorporation and bylaws. In DE, most poison pill plans are fine as long as they are redeemable (*Moran*) but not dead-hand or no-hand SH rights plans (*Quickturn*; *Carmody*). The classified board is also likely okay because it was agreed to in the articles of incorporation.

The next inquiry is whether the board was reasonable in belinging that the takeover was a threat to corp policy and effectiveness. They must show good faith and reasonable inestigaiton and any proof will be materailly enchanced if a majority of the board is independent (that would be nice to know) and even more so if the investigation was

handed offer to an independent committee. Here there is no threat to long standing business stategy or interference with a long planned merger. There is also very little concern about the quality of consideration or that there is a front-loaded two step buyout that will hurt SHs who tender later. Perhaps when the TO was first made the board could claim that the SHs wouldmistakenly take the offer when the shares were worth more because the Toriander seeds true value was known but concern is gone now and the market has responded to this new information. At the very most there could be a claim that the threat was a conditional offer, requiring that the pill be redeemed but the whole point of the pill to get the parties to the table to negotiate and then to be redeemed. This miscontrues the point of the poison pill to call the conditioned redemption a threat to corp policy or effectiveness. They best claim is that the offer is inadequate because the intrisic value is greater but given what Pfizer is saying that looks shaky.

If there is a threat (which looks tough here) the next inquiry is whether the board was reasnable, whether the defensive measires were proportional to the threat. The defensive measures cannot be draconian; preclusive or coercive (*unitrin*). As the threat was minimal the defensive measures must be minimal. The poison pill by itself wouldn't be a big deal but combined with the board classificaiton this very likely preclusive. It makes it almost impossible for their to be TO which keeps the SHs from being able to take advantage of it and the SHs have no power to get a new board because they cannot call a special meeting and when the board does come up for reelection it can only replace 1/3 of them.

Becuase of the preclusiveness of these measures the board will not get to BJR and

the defenses will likely be enjoined.

Revlon:

There is an open question whether the Revlon duty is triggered here. There is only one Revlon duty and that is to maximize the SH value in the short term. It is only triggered when a corp embarks in a transaction that will result in the change of control (which includes a breakup of the corp) (lyondell). Here it is not clear that the board has embarked on a transaction but it is possible that once the TO went to $90 that the buyout was enevitable and therefore the change from a "fluid aggregate" of SHs to WFC as the controlling SH would be enough. Revlon is not a fully fleshed-out doctrine yet, it is a little mushy but the ultimate question is whther this is an end of life situation, a last chance to get the SHs a control premium and if the defenses fail Unocal then that very well could be the case here.

Blasius:

When defensive measures disenfranchise SHs there must be a compelling justification for using them. Here there doesn't seems to be any such compelling reason and the classification of the board along with the inability of the SHs to use there only real remedy of replacing the board or selling their shares (because they can't call a special meeting). This may be enough to trigger compelling justification review but it is unclear because of the fact that the classification and the lack of SH rights to call a special meeting are in the articles of confederation but it is possible to strike even that if

---

necessary (though it likely won't be if the defenses fail unocal).

Answer-to-Question-_3_

Form of Business Organization:

As a general rule the corporate form is superior to partnerships because of its limited liability, its centralized management, the liquidity of the assets and its difficult to kill strong legal personality. Because Partnerships open the partners up to so much liability (joint and several for torts, joint for debts, the requirement to meet partners unmet contribution, etc) it is probably wise to avoid them. Additionally, the indefinite relationship that these three want would lead to a sort of partnership at will which, as the name suggests, could be terminate at any time for any reason by the partners. This can cause dissolution before the goals of the partnership are met.

Corporation on the other hand are difficult to kill and they can survive the coming and going of “partners.” If two of the three want to carry on that is much easier in a corporation setting. There is the opposite concern though that a corporation would bring in this case is that it is difficult to terminate. Especially in the close corp realm, there isn’t a market for the shares/interest in the corp and so buyout agreement would need to be made (more on this later). In the close corp context this can lead to freezouts and oppression. Additionally, corporations focus on centralized management is not

necessarily a plus for these three because they will be the only managers.

All around it looks like what would be best for these three is a limited liability company, a closely held corporation. It is in some senses the best of both worlds. It has the liability structure of the corp (no personal liability for corp debts or the acts of others in the corp...unless the corporate veil is pierced, which it shouldn't be with good planning), the partnership like management structure where the three of them can work together. They are slightly more able to terminate but are also more durable than partnerships and have greater liquidity than full-fledged corporations.

Legal Duties and Risks:

Close corps have many of the same legal duties as partnerships. The duty of the utmost loyalty and good faith (Wilkes). The directors must be willing to work together. There is the risk that there will be disagreements about policy and how the corporation should be run. When that happens the actions of two (a majority here) will trump the privilege of the other whether or not it is the right plan. There will be concerns about voting shares or increasing the size of the corp. They mentioned that they would need to get more buses and hire more people if they need to grow but who will make this decision? What if there is a dead-lock (more difficult with three people than two but still). There is also the risk that the three of them will realize this is a bad plan and want to get out. They need to be willing to plan ahead for this. This can be difficult because at the beginning of these relationships everyone thinks they will get along forever and they may (unlikely but maybe). All the same, these things must be talked about and planned for.

Planning Ahead:

The important thing is to get counsel from professionals that specialize in limited liability corporations. Get their advice. In the meantime, the three of you should definitely work out exit strategies, election considerations and dispute resolution.

Vote pooling agreements are acceptable (*ringling*) and such agreements can include the elections of each other for positions as both Directors and officers as long as there are fiduciary outs (*Clark*). Such an agreement might be a good idea. It will also be important to establish how the shares of the corporation will work. Will each share be vote or will each holder get a vote? Generally, pro rata voting is the norm that that is one thing to consider.

Additionally, whether the problem be in not wanting to adhere to voting agreements made or any other dispute a resolution plan should be in place. Arbitration by a third party, negotiation, or the cts, whatever it is there should be a process. There must also be an agreement to abide by the authority of the resolutions worked out.

Finally, exit strategies. Without some explicit agreement about what happens when one of you decides to leave or must leave (death, sickness, etc.) there will be chaos and self-serving instincts will reveal themselves. Leaving it up to the cts is risky and likely expensive (*Brodie*). It is also important to remember that the cts will never grant a remedy (or at least they will try really hard not to) that will put a partner in a better

position than you would have been had the freeze-out or other problem not happened (*Brodie*). The kinds of agreement you should look to are buy-sell or other such agreements. This allows partners to exit the firm at a fair price without ripping off those that are staying. Also, i would incorporate in DE, they are pretty business savvy and their Limited Liability Company Act is pretty good to partnership interests (*Haley*).

Answer-to-Question-_4_

SH proposal are governed by SEC Rule 14a-8. In order to submit a proposal the SH must hold at least $2000 (market value) or 1% of the corps voting stock for one year prior to the proposal and these stocks must be held through the meeting. The proposal must not be more than 500 words and there must be no more than one proposal The corp may include in the proxy statement a statement why the proposal should not be adopted and if it decides to exclude the proposal the corp has the burden to show that it should be excluded. If it is not excluded for those of these procedural matters then there are 13 other possible grounds for exclusion under 14a-8(i).

Corp X could try to exclude MinFunds proposal on several these. X could claim that this was an irrelevant proposal as it doesn't touch on greater than 5% of corps total assets but because it deals with SH voting rights it probably meets the "otherwise significantly related" qualification (*Lovenheim*). The two strongest cases X corp would have is that it is excludable because it deals with elections or because it is a violation of law.

The front end of this proposal looks an awful lot like (Former)Rule 14a-11 which gave 3% SHs the right put forward a short slate (1 nominee or 25% board, whichever is greater) but this was struck down by the cts. It is possible that this could be a concern

---

even as a bylaw, it may need to be an amendment to the articles of confederation to guarantee it will not be overturned by a court challenge.

In *AFSCME* the DE cts allowed proposals that were about election **procedures** and this seems to fit the bill. It is not trying to get a specific director voted in but to determine the procedure why which a director can be nominated. Additionally, it held that DGCL §109(a) gave the SHs the power to amend and repeal bylaws without the directors consent and so it looks like it would fly. Still, elections are a shady ground for proposals. Any time you leave it to the court to make a substantive/procedural distinction you are taking your life in your hands.

As the the second question, whether the addition to the bylaw is permissible under DE law, the answer seems to be yes but it is a little unclear. In *CA, Inc.* the court found, because of the clash between DGCL §109 and §141(a) (which 141(a) wins by the way) that proposals requiring expenses be reimbursed for nominations were excludable under Rule 14a-8 but it did so because there was no fiduciary out. Here, there is a fiduciary out. The board is not required to reimburse if their “qualified outside law firm” says that the boards fiduciary duties “clearly required them to refrain from reimbursing such expenses.” The only complaint that may be had here is the wording: “clearly.” The corporation will not like that because fiduciary duties are rarely so clearly violated when there is good faith no to violate them. It would seem that at most the board could push to have this word removed but given the ruling in CA, Inc. it looks like this additional piece to the SH proposal is not contrary to DE law.