

**University of Illinois College of Law  
Examination Cover Sheet**

**Business Associations 2**

Professor Amitai Aviram

Spring Semester 2012

Number of Pages: 5 (including this page)

Time Allotted: Until 10am on the day following the day you received the exam

**Exam Instructions**

1. **Permissible material:** This is an open book exam. You may use any materials you want, whether in hardcopy or electronic format.
2. **Anonymity:** The exams are graded anonymously. Do not put your name or anything else that may identify you (except for your four-digit exam ID number) on the file that contains your answer to the exam.
3. **Receiving and submitting the exam**
  - a. You must personally pick up a copy of the exam from Tina Lamb (Room 324) between 9-10am on one of the following days: May 2, 3, 4, 7.
  - b. You must submit your response as a .doc or .docx (Microsoft Word) file e-mailed to Tina Lamb (tinalamb@illinois.edu) no later than 10am on the day after you received the exam. The file name should be your 4-digit exam ID number.
4. **Confidentiality**
  - a. Once you receive this exam form, you are not allowed to discuss the exam with anyone until after the last day of the exam period.
  - b. Students who are enrolled in this course are not allowed to solicit or receive information about the exam if the source of this information (directly or indirectly) is a person who has seen the exam.
  - c. After the last day of the exam period, you are allowed to freely discuss the exam.
5. **Writing the exam**
  - a. The exam contains two questions. Answer one of them. I will grade only the question you answered first.
  - b. Unless the exam question specifies otherwise, assume that the relevant jurisdiction applies the Restatement (Third) on Agency, Delaware corporate law RUPA, and U.S. securities law.
  - c. Cite relevant case and statutory authority.
  - d. Within the constraints of the length limit, answer all relevant issues that arise from the fact pattern, even if your conclusion on one of the issues is dispositive to other issues.
6. **Length limit:** If you answer question 1 –
  - a. The total length of your answer should not exceed 1,000 words.
  - b. **For every 10 words in excess of the length limit (rounded up), one point will be taken off the exam's raw score.**
  - c. This section does not apply to students answering question 2.
7. **"Fact" patterns are fiction:** The "facts" presented in this exam were constructed for an educational purpose, and are not intended to inform about any real person or event.

## **Question 1**

**Wonka's world:** The Willy Wonka Candy Company (“WWCC”) is a Delaware corporation that produces candy. WWCC has several wholly-owned subsidiaries (also Delaware corporations), including Wonka Hard Candies (“WHC”), which among other things manufactures the Everlasting Gobstopper, a very popular hard candy. WWCC also manufactures a variety of other candies, chocolates and chewing gum.

WWCC has a single class of shares, with 20M authorized shares. 8M of those shares were outstanding ten years ago, and Wonka owned all of them. That year, WWCC issued shares to children who bought WWCC products, and registered its shares for trading on the New York Stock Exchange. Soon, Wonka discovered that he does not like children and WWCC stopped issuing new shares. However, by that point WWCC had issued 2M shares to children (so in total WWCC had 10M outstanding shares and Wonka owned 80% of them). Other than Wonka, no shareholder owned more than 10K shares. WWCC trades for about \$50 a share.

WWCC's bylaws state that the board of directors consists of three directors. Currently, WWCC's directors are Willy Wonka (“Wonka”), Wonka's father Wilbur Wonka (“Wilbur”), and Mr. Wilkinson (“Wilkinson”), a billionaire who has no affiliation with Wonka or Wilbur (other than sitting with them on WWCC's board). Neither Wilbur nor Wilkinson own WWCC shares.

**Slugworth spies:** Last year, rival company Slugworth Chocolates Incorporated (“SCI”) began to sell “Perpetual” – a hard candy that is almost identical to the Everlasting Gobstopper. Wonka suspected that a WWCC employee sold the secret formula for Everlasting Gobstoppers to SCI.

At the next WWCC board meeting, he proposed two responses. First, he wanted to sell WHC, because he had no interest in hard candies now that they faced competition from “thieving rivals”. He proposed that the board appoint Wilkinson as a one-person board committee to identify buyers for WHC and negotiate a deal to sell WHC. Second, he wanted to fire all WWCC employees, and employ instead a tribe of Oompa-Loompas (tiny, green-haired and orange-skinned humans who live on a remote island in the Atlantic Ocean). The Oompa-Loompas were willing to work for no pay other than food and cocoa beans, and because they were so little they did not eat much (indeed, labor costs would amount to less than 0.01% of WWCC's sales or its profits). With no workers that have connections to the outside world, WWCC would be immune from industrial espionage. The board discussed the proposals and after due deliberation approved both.

**Secret side-deal:** Wilkinson investigated potential buyers for WHC, and contacted Arthur Slugworth (“Slugworth”), the CEO of SCI. While negotiating with Slugworth, Wilkinson told him that if SCI bought WHC, he (Wilkinson) would be interested in purchasing from SCI the candy factory that manufactures Everlasting Gobstoppers (the “EG factory”), which was among WHC's assets.

Slugworth made no promises at that meeting, but after the meeting Slugworth's lawyers informed him that an acquisition of WHC by SCI would probably not receive antitrust approval from the government because of the competitive effects of owning both the Everlasting Gobstopper and the Perpetual brands. The lawyers believed that SCI would need to sell one of the brands to get antitrust approval.

In their next meeting, Slugworth told Wilkinson that if SCI bought WHC for \$150M, they would sell the EG factory to Wilkinson for \$5M. Wilkinson and Slugworth quickly finalized the deal and Wilkinson recommended to WWCC's BoD that they accept SCI's offer (not mentioning his agreement regarding the EG factory). After due deliberation, the BoD unanimously accepted the offer.

**Punishing publicity:** A few days later, the Urbana Financial Times published a front-page story on WWCC, insinuating that Wilkinson acted improperly in negotiating a side deal for himself while negotiating the sale of WHC. The article also suggested that WWCC exploited the Oompa-Loompas & violated the Fair Labor Standards Act (FLSA).

Charlie Bucket ("Charlie"), who owned one WWCC share for several years, was very upset to read about the exploitation of the Oompa-Loompas. He wrote a letter to WWCC's board, demanding that WWCC add the following proposal to the BoD's proxy card for the next shareholder meeting: "The shareholders resolve to amend the company bylaws by adding bylaw 5.67: 'Oompa-Loompas who are employed by the company will be paid a salary, in cash, of no less than \$20 an hour.'"

Meanwhile, Violet Beauregard ("Violet"), an aspiring securities lawyer, decided to sue Wilkinson for his side deal with SCI. Concerned that the Urbana Financial Times article did not provide enough information to ensure that her complaint survived a motion to dismiss, she decided to investigate further using shareholder inspection rights. Since she had not been a WWCC shareholder, Violet purchased a WWCC share & then wrote a letter to WWCC's BoD, invoking her shareholder inspection rights to request a copy of the minutes of the BoD meeting that approved the sale of WHC, as well as any documents or representations made to the BoD during that meeting (all together, the "requested documents"). As her purpose, she cited her intention to sue Wilkinson for his side deal with SCI, if the facts suggest he had violated his fiduciary duties. Violet also wrote that if the requested documents are confidential, she was willing to sign a confidentiality agreement.

WWCC's board discussed both letters and decided to reject both. WWCC informed the SEC that they decided to exclude Charlie's proposal from the BoD's proxy card and requested a "no-action" letter. Meanwhile, Violet sued WWCC, demanding that WWCC comply with her SH inspection rights and provide her the requested documents.

**Wrathful Wonka:** The press continued to criticize WWCC for its Oompa-Loompa employment policy. Three WWCC shareholders – Augustus Gloop ("Augustus"), Mike Teevee ("Mike") and Veruca Salt ("Veruca") – created a nonprofit association called "Save our Oompa-Loompas" ("SOOL") to change WWCC's Oompa-Loompa policies.

SOOL launched a highly-publicized proxy contest (using its own proxy card) to elect Augustus, Mike and Veruca as WWCC directors. They promised that if they were elected, they would return the Oompa-Loompas to their island and rehire the previous WWCC employees.

At the shareholder meeting, 8.2M shares voted for the BoD's slate of candidates (Wonka, Wilbur and Wilkinson) while 0.5M shares voted for SOOL's slate (Augustus, Mike and Veruca). While Wonka won, he was very upset that so many shareholders voted against him, and decided that the shareholders don't deserve his company.

Wonka suggested to the BoD that he would buy out the other shareholders of WWCC. The BoD decided to appoint Wilkinson as a one-person BoD committee, instructing him to negotiate a freezeout merger at a price that is fair to the minority shareholders. They authorized the committee to have unlimited use of the company's lawyer and investment banker for any advice and analysis Wilkinson might need. To assert his independence, Wilkinson promised that after the freezeout took place he would step down from his directorship at WWCC and would not collect any severance payment.

After thorough analysis, Wilkinson concluded that the value of a WWCC share with a control premium is \$80. However, because Wonka already controls WWCC, no other bidder could buy control of WWCC, and therefore no other bidder would offer such a high price for the minority's shares. Therefore, Wilkinson decided to demand a price of \$65/share (\$15 above the market price of the shares), splitting the control premium evenly between Wonka and the minority shareholders. He negotiated the terms of a long-form triangular merger in which minority WWCC shareholders were cashed out at \$65/share ("the merger"). The merger was approved by WWCC's board.

In a duly-called special shareholder meeting, 8.5M shares (including Wonka's 8M shares) voted in favor of the merger, and 0.1M shares voted against (the remaining shares did not participate, neither in person nor by proxy). Veruca voted against the merger, but did not notify WWCC that she intended to demand appraisal rights.

When the freezeout merger closed, Veruca's shares were cancelled and she received a \$65/share payment. Veruca then sued Wonka for the difference between her shares' fair value and the \$65/share she received, claiming that the freezeout merger amounted to self-dealing that breached Wonka's fiduciary duty.

**Discuss the SEC's decision on the "no-action" letter, Violet's suit and Veruca's suit.**

## Question 2

Note: The effective date for this question is **April 27, 2012**. In answering this question, please disregard any real world information that came out after the effective date.

From: Ben I. Graham [mailto:Mr.BIG@work.com]  
Sent: Monday, April 30, 2012 9:00 AM  
Subject: Boxing Jack

The Board of Directors of Jack in the Box, Inc. (NasdaqGS:JACK) (“JACK”) has retained us to advise it regarding an unsolicited offer it received to acquire Qdoba Mexican Grill (“Qdoba”), a restaurant chain owned by JACK.

Last week JACK’s CEO, Linda Lang (“Lang”), was contacted by a closely-held Delaware corporation called Qdoba Acquisition Vehicle, Inc. (“QAV”), with a proposal that QAV will acquire Qdoba from JACK. QAV is controlled by BlackRock, Inc. (NYSE: BLK) (“BLK”), which owns all of QAV’s common shares. QAV also has preferred shares, which have no voting rights but have the rights to 99% of QAV’s economic rights (dividends & assets at liquidation). The preferred shares are owned by several subsidiaries and funds that are controlled by BLK, FMR LLC (“FMR”), and Blue Harbour Group, L.P. (“BHG”). [Exam note: FMR and BHG are real companies, though they are not publicly traded; QAV is a fictitious company.]

Lang told QAV that the price offered was far too low, but that in any case Qdoba is not for sale at this time. QAV warned Lang that it intends to acquire Qdoba, and will take their case to the shareholders if needed. Lang immediately informed JACK’s board of QAV’s offer. The board unanimously agreed that Qdoba is not ripe for sale, and that the best way to maximize Qdoba’s sale value is to develop it for a few more years (and then, most likely, sell it to the public in an IPO). The board agreed with Lang that QAV’s offer is opportunistic, hoping to buy Qdoba cheaply now and then sell it to the public (as JACK is planning to do) in a few years. It unanimously voted to reject QAV’s offer, and informed QAV that Qdoba is not for sale at this time.

QAV is likely to seek ways to force JACK to sell Qdoba. **I need you to prepare, by 10am tomorrow, a memo to JACK’s board that: (i) identifies ways in which QAV may act to pressure JACK to sell Qdoba; and (ii) assess current defenses against such actions and propose actions to create additional defenses, if feasible.** Gather any information you need from public sources.

Thanks!

## Business Associations 2 – Spring 2012: Answer to Question 1

1. **“No-action” letter:** WWCC can exclude Charlie’s proposal under Rules 14a-8(i)(1) and (3), and possibly but not likely under Rules 14a-8(i)(5) and (7).
  - (a) 14a-8(i)(1): Improper under state law – shareholders may amend bylaws, but a bylaw may not contradict with the BoD’s authority to manage the business and affairs of the corporation under DGCL 141(a). The test (CA) is whether under some set of circumstances following the bylaw could cause the BoD to breach their fiduciary duties. Here, bylaw would require BoD to pay salaries that could exceed the value received by WWCC (agreeing to corporate waste). Also, bylaws should determine process, not specific decisions, whereas the proposal specifically decides Oompa-Loompa salaries.
  - (b) 14a-8(i)(3): Violation of proxy rules – Charlie owns only one WWCC share, which is worth \$50 and is far less than 1% of WWCC’s securities entitled to vote, and is therefore ineligible to make a proposal (Rule 14a-8(b)(1)). WWCC must notify SH of procedural defects within 14 days unless defects cannot be remedied (Rule 14a-8(f)(1)). Charlie cannot remedy the defect: even if he bought more shares, he wouldn’t have held them for a year as required in Rule 14a-8(b)(1).
  - (c) 14a-8(i)(5): Relevance – The cost of employing Oompa-Loompas is under 5% of WWCC’s net earnings and gross sales (and doesn’t relate to WWCC assets). However, violating the FLSA and the bad publicity this would cause would likely be “significantly related to the company’s business.” Therefore, this justification for exclusion likely fails.
  - (d) 14a-8(i)(7): Management functions: Charlie’s proposal is related to routine employment contracts, which are part of ordinary business operations. However, analogous to *Cracker Barrel*, the proposal addresses a social issue (exploitative employment conditions), which goes beyond ordinary business. Therefore, this justification for exclusion likely fails.<sup>1</sup>
2. **Violet’s suit:**
  - (a) Since Violet is asking for information other than the SH list, under DGCL 220(c) she bears BoP that the inspection is for a proper purpose. Gathering information to establish a lawsuit against Wilkinson for his side deal with SCI is a proper purpose (in that it’s “reasonably related to [SH’s] interest as a stockholder” (DGCL 220(b)). She also must comply with the *Pershing Square* qualifications:
    1. Credible basis: The report in *Urbana Financial Times* on Wilkinson’s side deal gives Violet credible basis.

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<sup>1</sup> Several exams argued for a personal grievance ground for exclusion (14a-8(i)(4)), but it is inapplicable because Charlie’s concern for the welfare of the Oompa-Loompas, even if it is not shared by most shareholders, is not a personal claim, it does not benefit Charlie or furthers his personal interests.

2. Necessary and essential: Evidence showing what directors knew when they approved the deal is necessary and essential to show BoD did not approve Wilkinson's side deal.
  3. Confidentiality: Violet is willing to address confidentiality concerns.
  4. True/primary purpose: Suing Wilkinson cannot be Violet's true purpose because Violet is procedurally barred from bringing this claim.<sup>2</sup>
- (b) Violet can't sue, so she can't inspect records for purpose of suing.
1. The claim against Wilkinson is derivative. WWCC, not SHs individually, suffered the harm from Wilkinson's alleged behavior (if Wilkinson supported an inferior SCI offer so he could buy the EG factory), and the remedy (disgorgement or damages) would go to WWCC (*Tooley*).<sup>3</sup>
  2. Plaintiff in derivative action must satisfy contemporaneous holding rule (Chancery Rule 23.1), but Violet wasn't a SH when alleged wrongdoing occurred.
3. **Veruca's suit:** Appraisal by right: Veruca lost her appraisal rights by not notifying WWCC, prior to vote, of her intention to seek appraisal. But she is seeking an appraisal remedy not by right but to remedy an alleged breach of FD.
- (a) Standing: Veruca no longer owns WWCC shares, so she violates the contemporaneous holding rule (Chancery Rule 23.1) if the suit is derivative. However, her suit is direct. Applying *Tooley*, MSHs (not WWCC) are harmed from low freezeout price, and if FD was breached, appraisal goes to MSHs, not WWCC. Applying *Agostino*, Veruca wins if she shows MSHs received unfairly low price for their shares due to self-dealing, even though WWCC is unharmed by the price MSHs receive. Therefore, suit is direct.
- (b) Duty: Wonka controls WWCC (owns 80% of WWCC's shares, he and his father are a majority on BoD). Under both *CNX & Khan*, controllers owe a FD to MSHs in a freezeout.

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<sup>2</sup> Several exams argued that the fact that the suit will advance her legal career makes it improper (as unrelated to her interest as a SH) or not the true purpose. But the benefit to her legal career is aligned with her interest as a SH – both require successful prosecution of the case against Wilkinson. If Violet had standing to bring the suit, the fact that she would also get a reputational benefit or personal experience from suing would not make the purpose of the SH inspection improper, as long as her personal incentive is to act in a way that benefits all SHs: win the suit. Violet's purpose is improper because she doesn't have standing to sue and therefore cannot achieve the purpose, not because her motivation is opportunistic (as long as her opportunistic behavior is aligned with the interests of the other SHs).

<sup>3</sup> In contrast, the claim against WWCC to facilitate inspection rights is direct: the harm from denial impacts Violet directly, and the injunctive remedy is to provide information to Violet individually. Several exams failed to distinguish or confused the standing issue of Violet's claim for inspection rights and the underlying claim against Wilkinson that she was investigating.

- (c) Screen: Under *CNX*, BJR applies to freezeout merger if:
1. Transaction was negotiated & approved by special committee of independent directors. Here, Wilkinson is independent (under *Beam* test, the billionaire who is about to resign from WWCC is less likely to risk his reputation than his relationship with Wonka). But he didn't have independent advisers (used company's lawyer and banker), and he was instructed to negotiate the deal with Wonka, rather than seek other, preferable deals or block the Wonka freezeout if it's not in MSHs' interest.
  2. Transaction was conditioned on the affirmative vote of the majority of MSHs. Here, transaction was not approved by a majority of all MSHs (500K of 2M), and approval was not an unwaivable condition.

Process fails both *CNX* prongs; entire fairness applies (see 4e below).

- (d) If *Khan* rather than *CNX* is the controlling law, entire fairness applies to all long-form freezeout mergers. BoP to show fairness depends on MSH vote. Here, 500K MSH votes supported the merger and 100K opposed it, so majority supported the merger (BoP is on plaintiff to show unfairness). However, *CNX* clarified that MotM requires majority of all MSHs, not only those voting. If that applies to *Khan*, 500K of 2M votes supported the merger – not a majority, so BoP is on defendant to show fairness.
- (e) Breach: Fairness includes fair process and fair price (*Weinberger*). Process was flawed (see 4c). Price seems to be arbitrarily – splitting the control premium 50/50 rather than based on relative bargaining power. However, no other bidder would offer a control premium if Wonka refuses to sell to them, so WWCC's bargaining power is limited to blocking Wonka's freezeout, without creating an alternative deal. Likely unfair because of flawed process. MotM vote cannot be seen as ratification, because SH vote was necessary to approve the merger (*Gantler*).