

University of Illinois College of Law Examination Cover Sheet

Business Associations

Professor Amitai Aviram

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Number of Pages: 5 (including this page)

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

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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. Notify my assistant immediately (within 1 hour) if you did not receive by e-mail a copy of the exam by 10am on the day you selected (or on the default date, if you did not select an exam date).
 - b. You must submit your response as a .doc/.docx (Microsoft Word) file e-mailed to my assistant 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:** 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. Students enrolled in this course are not allowed to solicit or receive information about the exam if the source of the information (directly or indirectly) is a person who has seen the exam.
5. **Length limit:** The total length of your answer may not exceed 1,000 words. For every 10 words in excess of the length limit (rounded up), one point will be taken off the exam's raw score.
6. **Answering the exam:** Cite relevant case and statutory authority. Subject to 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.
7. **Assumptions:** Unless the exam question specifies otherwise, assume that -
 - a. The relevant jurisdiction applies the Restatement (Third) on Agency, Delaware corporate law, RUPA, and U.S. securities law.
 - b. Each corporation's charter states that: the corporation is a stock corporation, has limited liability and perpetual existence; the corporation may conduct any lawful act or activity; director fiduciary duty is limited to & director/agent right to indemnification is extended to the maximum degree allowed under DGCL §102(b)(7) ; the board may amend the bylaws.
 - c. Each corporation's bylaws state that: the chairperson of the board is authorized to call a board meeting; and the board is authorized to call both annual & special shareholder meetings.
8. **"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.

Note: Though events in this fact pattern occur outside of the United States, for the purposes of the exam applicable law is the default law stated in exam instruction 7(a).

HSBC Holdings (“HSBC”) is a large multinational bank. Among its many branches, it has a branch in the Principality of Monaco (the branch is part of HSBC, not a separate entity). Dmitry Rybolovlev (“Dmitry”) is a Russian billionaire and an art collector. Many of Dmitry’s financial assets are managed at HSBC’s Monaco branch by Bert, who works at HSBC’s Monaco branch.

Recently, Dmitry hired the Swiss art dealer Yves Bouvier (“Yves”) to find and acquire a particular painting Dmitry was interested in, called “The Curse of Fortune”. For security reasons, the owner of “The Curse of Fortune” kept this fact a secret, which is why Dmitry needed to hire Yves to use his connections to find who owned the painting and offer to purchase it. Dmitry and Yves agreed that Yves would not get paid if he failed to locate the painting; would get paid \$1M if he located the painting but Dmitry and the owner could not agree on the sale of the painting; or would get 10% of the price of the painting if Yves located the painting and the owner agreed to sell it to Dmitry.

It took a few weeks, but eventually Yves told Dmitry that he located the owner, who was willing to sell the painting for \$250M. This was higher than Dmitry expected, but he decided to buy it. He transferred \$275M (\$250M + \$25M for Yves’ 10% commission) to Yves. Soon after that, Yves delivered the painting to Dmitry.

Dmitry was delighted – at least until he received an offer from fellow art collector Sam, who said he would buy the painting for “\$165M, 10% above what you paid for it”. When Dmitry told Sam he did not pay \$150M for the painting, Sam told Dmitry that he knew Dmitri did pay \$150M, since he (Sam) tried to get the painting, and managed to identify the painting’s (former) owner, but by then the owner told Sam he had sold the painting for \$150M to Yves, who was buying on Dmitri’s behalf. This is what led Sam to Dmitri.

Dmitri became concerned that Yves may have cheated him, buying the painting for \$150M but claiming it cost \$250M, then pocketing the extra \$100M (plus his commission) for himself. Sam wouldn’t tell Dmitri the identity of the buyer, so Dmitri had to find another way to investigate.

If Yves did overcharge Dmitri, he would be holding \$100M more than he should have (since he wouldn’t have delivered that amount to the painting’s seller as he claimed to). To be able to use this money without arousing suspicion, Yves would need to “launder” the money – do some fake transaction that would result in a \$100M “profit”, so he could claim that was how he came to have an extra \$100M. Dmitri hired a private investigator to snoop around Yves’ business activities and look for evidence of such money laundering. The investigator learned of rumors that days after buying the painting for Dmitri, Yves paid \$25M to Tanya Rappo (“Tanya”), a Monaco resident and international real-estate developer, for a portion of her shares in her (closely-held) real-estate business. A few weeks later, the investigator’s sources claimed, Tanya repurchased the shares from Yves for \$125M.

Dmitri felt his suspicions were confirmed. He theorized that Yves in fact paid Tanya for the shares not \$25M but \$125M (the amount left from Dmitri's \$275M payment, after paying \$150M to the painting's former owner), but Tanya falsely recorded the purchase price as \$25M, and later bought back the investment for \$125M, taking back her shares and giving back to Yves' the money he gave her – but now Yves could claim the extra \$100M were profits from his investment in Tanya business.

All Dmitri had, though, were rumors. If he could find actual records of these two transactions between Yves and Tanya, he would have strong evidence that Yves' cheated him. Dmitri contacted Bert at HSBC, and told him about his suspicions that Yves cheated him and then laundered the money with Tanya's assistance. Bert told Dmitri that both Yves and Tanya had accounts at HSBC's Monaco branch. Dmitri asked Bert to check if he can find records of the two transactions (\$25M transfer from Yves to Tanya and later \$125M transfer from Tanya to Yves). Bert responded that he is not allowed to share client account information with Dmitri. Dmitri became very agitated, and said he believed that Bert was protecting Yves and Tanya so that HSBC could benefit from their business. He said that if Bert kept protecting them, Dmitri will "take his money to another, more ethical bank". This worried Bert because Dmitri was by far a bigger and more profitable customer than Yves and Tanya.

Seeing a dead end investigating through HSBC, Dmitri contacted the Monaco police and filed a complaint for criminal fraud and theft of \$100M. He hoped that the police investigation would uncover evidence that would establish Yves' guilt.

To check the truth in the rumors Dmitri reported, the Monaco police contacted several banks it believed may have processed payments between Yves and Tanya. One of those banks was HSBC. The Monaco police contacted HSBC's Monaco branch manager. The branch manager forwarded the request to Bert, copying the police to the e-mail, and instructed Bert to "cooperate fully & honestly" with the police request, and "not to forget to check both electronic and paper records".

Bert was very eager to cooperate and, he hoped, establish Yves' and Tanya's guilt, since he feared losing Dmitri as a client. HSBC paid private bankers like Bert a low base salary, but offered very generous bonuses (equal to many times the base salary) based on the profits HSBC earned from the clients of the private banker. Dmitri was by far the biggest of Bert's clients, and losing his business would likely cost Bert about \$1M a year in bonuses.

Bert conducted a very thorough investigation of Yves' and Tanya's accounts, but he found no evidence of transactions between them. He called Dmitri to tell him that he found nothing, in the hope that Dmitri would be satisfied with the investigation and would not terminate his business with the bank.

But Dmitri was furious with Bert. He claimed that either Bert was incompetent or was protecting Yves' and Tanya. Either way, he said, he doesn't want such a banker. "If you care about me and about justice, look harder," he urged Bert at the end of the conversation.

Bert was in a bind. He feared that if he reported to the Monaco police that he found nothing, Dmitri would leave the bank, the bank would lose significant profits, and Bert would lose \$1M of bonuses per year. So Bert fabricated records that purported to show that Yves transferred \$25M to Tanya's account, and a few weeks later Tanya transferred \$125M to Yves' account. He sent these records to the Monaco police.

Based on these records, the Monaco police arrested Yves and Tanya. Both denied wrongdoing but were held in custody for a few days, and the arrest was widely reported in the news. After a few days, Tanya's lawyer was able to provide the Monaco police with documents that contradicted the records Bert gave the police. The police contacted HSBC's General Counsel, who investigated and quickly found that the information Bert provided was incorrect and likely forged. HSBC's General Counsel reported this to the Monaco police, fired Bert, and told Tanya and Yves that "HSBC apologizes and takes full moral responsibility for Bert's misconduct". The Monaco police released Yves and Tanya.

Tanya sued Bert for providing fabricated records to the Monaco police, which caused her arrest and harmed her reputation. Bert was found liable in torts to Tanya for providing the fabricated records, and damages were found to be \$3M. Bert, however, was bankrupt and unable to pay any damages. Tanya now sued HSBC, claiming HSBC was liable for the \$3M. She conceded that HSBC was not negligent in selecting, supervising or controlling Bert.

* * *

While HSBC's General Counsel was awaiting the court's decision on Tanya's suit, he was informed of a new legal issue. A small bank called Midwest Banking Corp. ("MBC"), which is a publicly-traded Delaware corporation, has recently decided to put itself up for sale. MBC's board shopped for potential acquirers, held discussions with them, and finally determined that HSBC offered the best terms for MBC's shareholders. HSBC then signed an agreement ("the deal") to acquire MBC for \$20 billion. The deal was conditioned on approval by MBC's shareholders, and had no termination fees (i.e., until approved by MBC's shareholders, either side could walk away from the deal without penalty).

MBC's board called a special shareholder meeting to vote on the deal. Two days before the meeting, Citibank (a large bank) made a competing offer to acquire MBC for \$20.5 billion. In response, MBC's board postponed the shareholder meeting by one month and agreed to HSBC's demand to negotiate exclusively with HSBC, refusing Citibank's request to negotiate with them as well.

After several days of negotiations MBC signed an amended agreement with HSBC, under which HSBC would pay \$21 billion for MBC ("the amended deal"). The amended deal was again subject to the approval of MBC's shareholders, and included a clause stating that if either party walked away from the amended deal for any reason (including shareholders' rejection of the deal), that party would pay the other party a termination fee of \$2 billion.

MBC's board approved the amended deal, provided its shareholders full disclosure about the amended deal and their negotiation efforts, and informed the shareholders that they would vote on the amended deal at the shareholder meeting. Assume that MBC complied with securities laws regarding the information and notice that needed to be given to shareholders to vote on the amended deal.

Before the meeting took place, Serena, an MBC shareholder, sued MBC's board (i.e., all of MBC's directors), requesting that the court enjoin the shareholder meeting to prevent a vote on the amended deal. Serena claimed that the board breached its fiduciary duty, both in the process of negotiating exclusively with HSBC (rather than forcing HSBC and Citibank to bid against each other), and in the substance (claiming the amended deal's terms were bad for MBC's shareholders). Serena has no concrete evidence of directors' self-dealing in negotiating and approving the deal, and concedes that the board had sufficient expertise and information and conducted a reasonable investigation, but argues that nonetheless and inexplicably the board chose to throw away an opportunity to get a better deal for MBC's shareholders.

Discuss Tanya's suit against HSBC, and Serena's suit against MBC's board.

Model answer for the Fall 2015 BA exam

Tanya v. HSBC¹: Tanya can point to three potential sources making HSBC's liability for Bert's tort.

1. **Actual authority**: Not initially, but possibly by ratification.

- a. Liability on the basis of actual authority requires an agency relationship. Here, Bert is HSBC's agent (see 4a).
- b. Bert did not originally have actual authority to forge the records under R3A §2.01, since HSBC's manifestation (via the Monaco branch manager) was to "cooperate fully & honestly" with the police, and Bert could not reasonably believe this meant forging records.
- c. Did HSBC ratify Bert's act by the General Counsel (GC) telling Tanya HSBC "takes full moral responsibility for Bert's misconduct"? HSBC was fully informed of Bert's act, and GC may reasonably believe he is authorized to ratify legal liability (depending on specific authorization of GC's office by board or bylaws). If so, the statement would amount to ratification if "moral responsibility" unambiguously includes legal liability for Bert's actions, despite HSBC's firing Bert (which shows they disagree with the misconduct, but doesn't preclude acceptance of legal consequences).

2. **Apparent authority**: Probably creates liability.

- a. HSBC is liable to Tanya under R3A §7.08, if "actions taken by the agent with apparent authority constitute the tort".
- b. Bert's provision of fabricated records to the Monaco police constituted the tort of defamation, which relied on Bert's apparent authority (R3A §2.03).² HSBC's Monaco branch manager made a manifestation to the police by copying them to the forwarding of the police request to Bert, with the instruction to "cooperate fully & honestly." This manifestation made the police reasonably believe that information Bert sent them was attributable to HSBC. The situation is analogous to a store security guard falsely accusing a shopper of shoplifting.

3. **Respondeat superior**: Very likely creates liability.

- a. Bert is an agent of HSBC under R3A §1.01 because he acts on HSBC's behalf in managing client accounts, and he is subject to HSBC's control because he must follow the instructions of superior HSBC employees (such as his branch manager who instructed him to handle the police request). He is further an employee under R3A §7.07(3) because HSBC controls not only the results of Bert's work, but also the manner and means of performing the work (such as the branch manager instruction to check both electronic and paper records).

¹ Tanya's suit is loosely based on John Letzing & Max Colchester, *HSBC Entangled in Artwork Feud*, WSJ (Nov. 20, 2015).

² Bert may have also committed a misrepresentation to the Monaco police, but they aren't suing him. Bert did not misrepresent to Tanya, but rather defamed her by misrepresenting to the Monaco police. Therefore, it is Bert's apparent authority in the eyes of the Monaco police (not Tanya) that matters for the analysis. Defamation involves misstatements made with apparent authority to someone other than the plaintiff (making false allegations only to the victim's ears doesn't defame the victim).

- b. Bert's provision of fabricated records was within SoE under R3A §7.07(2) because it was subject to the employer's control (instructing Bert which records to check), and under the purpose test his purpose was in part to protect the bank's profits by keeping Dmitri as a client. Existence of personal motivation (protecting his bonus) doesn't remove the act from SoE if it's partially motivated by wanting to serve employer's interest (*Reynolds, Meltzer*).
- c. HSBC is liable under respondeat superior because Bert was an employee and providing the fabricated records was within SoE.

Serena v. MBC's board

- 1. Duty: As directors, members of MBC's board owe MBC and its shareholders a FD.
- 2. SoR selection: Serena concedes there was no self-dealing, so entire fairness doesn't apply. Enhanced scrutiny applies for two reasons. First, in agreeing to sell MBC the board embarked on a transaction that would result in a change of control of MBC (*Revlon*). Second, in agreeing to a sizable termination fee, the board deployed corporate power (signing amended deal on MBC's behalf) against shareholders' right to vote against amended deal, since rejecting the deal results in MBC paying \$2B to HSBC (*Blasius*).³
- 3. Application⁴
 - a. Quasi-BJR: did board find, in good faith & after a reasonable investigation, a legitimate purpose that warranted the board's act? Yes.
 - 1. Legitimate purpose: Board could believe exclusive negotiations & termination fee were necessary to get HSBC to raise its offer to \$21B, and that this would maximize value for MBC's SHs. Purpose would be illegitimate, and board's action would amount to corporate waste, only if transaction is so one-sided that no business person of ordinary, sound judgment could conclude firm received adequate consideration. Here, in return for exclusive negotiations & termination fee, MBC received \$1B increase in acquisition price. No corporate waste.
 - 2. Good faith: Serena concedes there's no evidence of self-dealing.
 - 3. Reasonable investigation: Serena concedes that the board had sufficient expertise and information and conducted a reasonable investigation.
 - b. Was the act a reasonable response proportionate to the alleged purpose?
 - 1. Coercive? Exclusive negotiation with HSBC is not coercive because the resulting amended deal is subject to a SH vote, and SHs can vote against it. But the \$2B termination fee is likely coercive because if SHs reject the deal, they lose 10% of

³ Some exams mistakenly argued that the board deployed power against SHs' voting rights in failing to bring Citibank's offer to a vote. This is wrong because SHs don't have a right to vote on merger offers to the company that are rejected by the board. They only have a right to vote on something that is on the meeting agenda (or that they have a right to add to the meeting agenda). Merger agreements involve the firm, not just the SHs' shares, and they require approval of the board in addition to the SHs. Without board approval, SHs don't have a right to vote on a merger.

⁴ Serena isn't challenging the board's postponement of the meeting. If she were, she'd ask the court to force a vote (on the original deal), which would be odd since the original deal is inferior to both the amended deal and Citibank's offer. Rather, she is asking the court to prohibit a vote (on the amended deal), in the hope that this will force MBC to talk to Citibank. Therefore it was irrelevant to consider, in the enhanced scrutiny analysis, the board's postponing of the SH meeting.

their investment's value. Fee of ~3% of deal value tends to be reasonable; here fee is ~9.5% of MBC's value. If termination fee is deemed coercive, amended deal was an unreasonable response and board breached FD; Serena wins.

2. Preclusive? No. Neither exclusive negotiations nor the termination fee were preclusive, because they didn't make alternative deals impossible. SHs may reject the deal (unless termination fee is coercive).⁵
3. Otherwise unreasonable? If termination fee is not so great as to be coercive, it's a reasonable way to get HSBC to make a better offer. As for exclusive negotiations, the fact that MBC had investigated other potential acquirers at beginning of negotiations process, and that the (original) deal had no termination fees and only yielded a last minute offer from Citibank gives the board a reasonable sense of what price acquirers would offer, so it doesn't need to competitively auction MBC again, and may agree to exclusive negotiations if board believes this is needed to cause HSBC to raise its offer.

⁵ The board's choice not to pursue Citibank's offer is not a preclusive act. The offer is not preclusive as long as SHs can replace the board and the new board could accept Citibank's offer. If the board agreed to never entertain offers from other bidders, even if and after the amended deal is rejected, this would be preclusive, but the exclusive negotiation commitment that was actually given lapses if the amended deal is terminated, such as if SHs rejected it. Therefore, it's not preclusive.