ST. MARY'S UNIVERSITY
SCHOOL OF LAW

Summer 2005
Exam No. __________

FINAL EXAMINATION
BUSINESS ASSOCIATIONS
PROFESSOR G. FLINT

ESSAY
PLEASE READ CAREFULLY

ALL ANSWERS ARE TO BE WRITTEN ON THE BLUE BOOKS PROVIDED WITH THIS EXAM

There are four questions (time and percent indicated). The Time for completing the examination is four hours.

1. This examination is "open book". You may use your casebook, statutory supplement, and class notes. Use of calculators and cleansed laptops is permitted.

2. **Be sure to answer the specific question that is asked. No question calls for a general recitation about a topic from your notes.** Information supplied relating to general material from your notes or some unasked question will not increase your score and consumes your time needed to answer the asked questions.

3. If additional facts are necessary to resolve an issue, specify what additional facts you believe to be necessary and why they are significant. You may not make an assumption that changes or contradicts the stated facts. Assume you are in the State of Texas and Texas law applies, unless otherwise clearly denoted.

4. Quality, not quantity, is desired. Think through and briefly outline your answer before you begin to write.

5. Write legibly. Be sure to formulate your answers in complete sentences and paragraphs with proper grammar. Failure to do so will result in an appropriately lower score.

6. Do not seek an interpretation of language in the question from anyone. If you sense ambiguity or typographical error, correct the shortcoming by shaping the question in a reasonable way and by recording your editorial correction in your answer.

Under the Honor Code, when you turn in this examination, you affirm that you have neither given, received, nor obtained aid in connection with this examination, nor have you known of any one so doing. If you cannot make this affirmation, you shall note such fact on your examination and must immediately advise the Dean of the reason therefore.

I. (25 %--1 hour)

Isaac Horatio Flint and Arunah Hubbell, both certified public accountants, years ago formed a partnership to conduct their budding accounting business. Isaac Horatio Flint handles the auditing business for the firm, Flint & Hubbell, CPA's, while Arunah Hubbell handles the firm's tax business. They each have several employees working under them, including a number of accountants. Arunah Hubbell has recently inherited several millions of dollars from his father Benjamin Hubbell.

In light of the recent Sarbanes-Oxley Act providing stringent requirements and liabilities for those handling audits of public companies, Arunah Hubbell has become concerned that a mis-step one of the novice accountants working with Isaac Horatio Flint in an audit of a public-company client could lead to significant liabilities for Flint & Hubbell, CPA's, exposing his new found wealth to confiscation by some enterprising plaintiff's attorney. Arunah Hubbell vaguely remembers something from his continuing accountancy education sessions about incorporation as a method to reduce one's personal liability for catastrophic events.

Arunah Hubbell and Isaac Horatio Flint have come into your associate's office at the Silk Stocking Law Firm, P.C. They want to know whether incorporation will reduce their personal liability and what legally needs to be done to carry out this restructuring of their business. What is your advice and its reasoning? Be sure to include your support.

II. (25%--1 hour)

Joseph Erwin and Robert Lee operate a solar panel manufacturing concern as a partnership. Joseph Erwin wants to expand the business, which requires additional capital. Joseph Erwin has found several investors, including Moses Smith and Dorothy Baker, who are willing to contribute $100,000 each for an interest in the partnership. Moses Smith is intrigued about the possibility of deducting research and development expenses on the partnership's endeavors to develop solar cells. Both Robert Lee and Dorothy Baker have reservations about this matter. Robert Lee does not want to surrender his percentage control of the partnership, Erwin & Lee. Dorothy Baker, approving of the possibility of capital appreciation if solar cells are marketed, is concerned about liability for the manufacturing mis-steps since she is married to a local millionaire, Michael Sweetman.

Joseph Erwin and Robert Lee have come into your associate's office at the Blue Blood Law Firm, P.C. They want to know how they should structure this investment and what legally needs to be done to carry it out. What is your advice and its reasoning? Be sure to include your support.

III. (25 %--1 hour)

Otha Albert Gasaway is the President of Gasaway, Inc., a Texas corporation, which develops software to assist businesses in their operations. Otha Albert Gasaway has attracted the interest of Garrett Voshell, a local investment banker. Garrett Voshell wants to take the Gasaway, Inc., public. As part of his due diligence, Garrett Voshell has uncovered several items that would make the offer of Gasaway, Inc., securities unattractive to public shareholders. So Garrett Voshell has placed conditions in his letter of intent to take Gasaway, Inc., public. These conditions relate to the following:

(1) The outstanding shares number 10,000,000. Former shareholders have recently sold their shares for $1.00 per share. The annual earnings of Gasaway, Inc., for the last several years have been about $700,000. Garrett Voshell wants the number of shares outstanding to be changed so that the value is about $20 per share.

(2) The directors, in particular Otha Albert Gasaway, have employee incentive options on an additional 10,000,000 shares. Garrett Voshell wants to sell to Texas residents and the Texas State Securities Board has a requirement that the company can not have outstanding options, the exercise of which would result in the issuance of additional shares that would number more than 10% of the outstanding shares. Garrett Voshell wants compliance with this Texas regulation.

(3) Gasaway, Inc., currently allows cumulative voting. Garrett Voshell wants cumulative voting removed.

(4) Garrett Voshell wants to continue to offer Gasaway, Inc., investment banking services after the offering. So Garrett Voshell has demanded a permanent position on the board for a member of his investment banking firm, Garrett Voshell and Associates.

Otha Albert Gasaway has come into your associate's office at Rapem, & Leavem, P.C. Otha wants to know what needs to be done to satisfy these conditions. What is your advice? Be sure to include your support.

IV. (25 %--1 hour)

Nicholas Pelletier is the President of Pelletier, Inc., a Texas public corporation, which manufactures computers. Recently, Pelletier, Inc., has announced increasing profits due to sales of numerous computers as a package system for large businesses. The sales are done on three-year credit with 10% down in cash. Generally Accepted Accounting Principles require only the portion of the expected income received to be recognized in the period of sale, with the rest amortized over the loan period. Nicholas Pelletier, however, believed that the entire expected income should be reported in the period of sale and did so in the unaudited quarterly statements made to the Securities and Exchange Commission. Augustine Rivard, Pelletier, Inc.,'s outside accountant has discovered this matter in conducting his annual audit of Pelletier, Inc.,'s books and is prepared to recommend the fourth quarter adjustment, which will report a significant loss for the year, rather than the profit Nicholas Pelletier has been telling the investment community. Nicholas Pelletier fears that the announcement of a substantial loss will cause the price of Pelletier, Inc.,'s stock to decline significantly and be accompanied by shareholder lawsuits against him.

Nicholas Pelletier has come into your associate's office at Suem & Stickem, P.C. Nicholas wants to know what he needs to do to minimize his director liability. What is your advice? Be sure to include your support.