ST. MARY'S UNIVERSITY SCHOOL OF LAW

Business Associations
Prof. Bernard D. Reams, Jr.

Final Examination
Fall, 2005

EXAMINATION NO. ___________ GRADUATING THIRD-YEAR (CHECK HERE) _______

FINAL EXAMINATION
(TAKE-HOME)

Instructions: There are three questions which are weighted equally: 1/3; 1/3; 1/3. All property on this examination is in Texas where all persons are domiciled. Depending on the fact pattern, either the Delaware Corporation Code, relevant Federal laws or Texas law governs as reflected in our statutory supplement. In addition, you may want to refer to the text of the Securities Exchange Act of 1934 and Rule 10B-5 and Rule 14a-9 and Sarbanes-Oxley, as well as relevant administrative regulations in the Code of Federal Regulations (C.F.R.) which is online.

Construct your answers carefully and respond specifically to questions, giving an explanation for all your conclusions.

RETURN THIS EXAMINATION ALONG WITH YOUR ANSWERS. Type your answers, doubled spaced, and use your examination number. Do not identify yourself. You may consult hard copy or computer sources. You are ***not*** to consult with others. These answers are to be your work product. You should plan to spend no less than three hours drafting your answers.

As a "take-home exam", this exam must be returned to my office, LF 234, in the Raba Building no later than 4:30 p.m. on Wednesday, December 14, 2005.

QUESTION I.

Oscar Able is the founder, chairman of the board of directors and chief executive officer of Coastal Resources Corporation, a publicly held Delaware corporation engaged in the business of exploring for, producing, and processing, oil and gas and other natural resources primarily in the Gulf of Mexico. Oscar Able owns approximately six percent of the common shares of Coastal Resources.

Oscar's thirty-year-old son, Oscar Able, Jr., is the principal shareholder in a closely held Delaware corporation, OAJ Shipping Corporation ("OAJ"). OAJ has purchased two old oil tankers, refurbished them, and leased them to Texaco and Exxon on a profitable basis. Oscar Able, Jr. learns from his father that Coastal Resources Corporation owns a twenty-five year old tanker, the *Duboise*, that is not seaworthy and has been tied up at a mooring near Houston for nearly a decade. Oscar, Jr. inspects this tanker and concludes that it can be refurbished and made serviceable at a reasonable cost. He, therefore, makes a written offer as President of OAJ to purchase the *Duboise* from Coastal Resources for $2,300,000 under a sale and leaseback arrangement. Under this arrangement Coastal Resources Corporation, after the *Duboise* is refurbished and certified to be seaworthy, would lease the *Duboise* for ten years at a base rental of $1,500,000 per year. At the end of ten years the lease would end.

The sale and leaseback arrangement is first presented to Coastal's executive committee. This committee consists of five senior executives of Coastal Resources Corporation, including Oscar Able. This committee met and released the following statement:

> The executive committee concludes that while the terms of the lease are reasonable and the transaction normally would be within the jurisdiction of the executive committee, the fact that the transaction is with a corporation owned by the son of Oscar Able requires that it be approved by the board of directors.

The board of directors of Coastal Resources consists of (1) Oscar Able, (2) Tom, the chief financial officer of Coastal Resources, (3) Dick, the chief operating officer of Coastal, and (4) four "outside" directors: two old friends who are college fraternity brothers of Oscar Able, Jack Welch, retired CEO of General Electric; Sandy Weill, former CEO of Citicorp. Other directors are the Honorable William Webster, former head of the Federal Bureau of Investigation (and a former federal judge); and Charles Cantu, an elderly retired law professor whose main interests are in Latin American probate laws.

At the meeting at which the proposal is considered, all board members are present. A motion is made by Sandy Weill that the proposed transaction be approved, and all those present (except Oscar Able who abstains) vote to approve the transaction.

Shortly after this decision is announced, John Teeter, an avid stockholder rights advocate and Rolling Stones Fan Club member, and an owner of two hundred shares of Coastal common stock, brings a derivative suit in the Delaware Chancery Court claiming that the terms of the transaction are unfair to Coastal Resources, that the transaction constitutes waste, and that it involves improper self-dealing by the Ables.

You are a clerk to the Chancellor of the Delaware Chancery court. Prepare a memorandum for the court. What should the court do with this lawsuit and why?

QUESTION II.

In 1999, Dan and Wyatt properly formed a Texas limited partnership to practice law in Texas. Dan was designated the general partner, and Wyatt, the limited partner. The partners agreed to share all fees equally, after payment of expenses.

In 2000, Dan, after consulting with and receiving affirmative advice from Wyatt, signed as general partner of the limited partnership a ten-year lease for office space at the cost of $10,000 per year.

In 2001, Dan, with Wyatt's consent, executed and filed an application for their firm to become a Texas registered limited liability partnership. The Texas Secretary of State approved the application in January 2002. Dan was designated as the managing partner, and the limited liability partnership thereafter complied with all formalities and legal requirements.

In December 2002, Dan awarded himself a small salary of $500 per month to compensate himself for the extra work he does as managing partner. The partnership agreement is silent on salary compensation for the partners, and Dan did not consult Wyatt on this matter. To date, however, Dan has not paid any of the salary to himself.

In 2003, Dan hired Abby, a young attorney to work as an associate for the partnership under Dan's supervision and direction. In the course of performing work in which Dan was directly involved for a client named Madisen, Abby committed malpractice. The malpractice caused Madisen $40,000 in damages. Wyatt first became aware of the malpractice after it occurred and too late to prevent or cure it.

Also in 2003, while consulting with a client named Courtney on regular firm business, Wyatt negligently dropped a printer on Courtney's foot. Courtney suffered injury and $10,000 in damages.

The partnership has no assets and was dissolved in 2004.

1. Are Dan and Wyatt, or either of them, personally liable to

    (a) The landlord on the office lease? Explain fully.
    (b) Madisen for damages resulting from Abby's malpractice? Explain fully.
    (c) Courtney for damages resulting from the injury to her foot? Explain fully.

2. Is Wyatt liable to Dan for the unpaid $500 per month salary? Explain fully.

[From the Texas Bar Exam]

QUESTION III.

Read this WSJ article first.

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BUSINESS ◆ By ALAN MURRAY

For Sarbanes-Oxley Bashers, Some Perspective

BASHING SARBANES-OXLEY, the law Congress passed to rein in corporate-accounting abuses, is popular locker-room banter among executives. But it has gotten out of hand.

On Sunday, Georgia-Pacific Chief Executive A.D. "Pete" Correll suggested avoiding the law was a reason to sell his company to privately held Koch Industries. "You get used to spending your shareholders money" on the law's provisions, he told reporters. "But that doesn't make it right."

Some commentators took Mr. Correll's suggestion even further. Sarbanes-Oxley, my former colleague Larry Kudlow told his CNBC audience, "is clearly leading to these privatizations."

Well, slow down, folks. A little perspective is in order.

A recent study by Foley & Lardner LLP found that all the costs associated with being a big public company averaged $14.3 million last year. That was up 45% from the year before, due largely to the requirements of Sarbanes-Oxley. But for a company like Georgia-Pacific, it's still not that big a number.

It's substantially less, for instance, than Mr. Correll himself stands to make from the 1.75 million shares of Georgia-Pacific stock and options issued to him by the company as of March 1 and now valued at $48 a share. (That's shareholder money, too, Pete.) And it can't even begin to explain why Koch is willing to pay a premium of nearly $4 billion above market value to take Georgia-Pacific private.

Sure, some of the mandates of the Sarbanes-Oxley bill—like the Section 404 requirement that companies certify their internal controls—are burdensome, especially to small and medium-size companies. And it's annoying that a law passed in response to accounting scandals has led to the proliferation and enrichment of accountants. All the new BMWs in the parking lot around audit time can't fail to catch a cost-conscious executive's attention.

BUT GET THEM away from the locker room, and many big-company CEOs will admit the law has done more good than harm. Some will even admit that the much maligned Section 404 has led them to make needed improvements in internal controls.

My guess is Mr. Correll's real complaint is about a broader trend, of which Sarbanes-Oxley is just a piece. (Mr. Correll declined to be interviewed for this column.) Chief executives of big public companies don't have the latitude today that they did when he took the job back in 1993. They're under pressure not just from regulators, but from newly energized boards, ambitious attorneys general, trial lawyers, nongovernmental organizations, activist hedge funds and countless other shareholder groups—all wanting a say in the company's affairs. For executives who like to run their own show, that's a nuisance.

Some determined CEOs have tried to hold back this tide by stuffing their boards with friendly faces—consider Morgan Stanley's former chief, Phillip Purcell—or by selling a portion of the company to a friendly outsider—consider Sovereign Bank's current chief, Jay Sidhu. But like Canute's commands, these tactics are doomed to fail. Mr. Sidhu likely will soon join Mr. Purcell in retirement.

That leaves public-company CEOs with just two options: Adapt to the new environment. Or go private.

Even with the surge of money moving into private equity in recent years, going private isn't really an option for most big companies. Mr. Correll was lucky. Why Koch Industries is so eager to pay top dollar for Georgia-Pacific is still a bit of a mystery.

UNLIKE MANY private-equity deals, there's no talk here of "leveraging" the company with new debt to increase owners' returns. Georgia-Pacific is already indebted to the tune of nearly $8 billion. And it's hard to imagine what synergies come from combining what is mostly an energy company with what is mostly a building-products and paper company.

The best rationale I've heard for the merger comes from analyst Steven Chercover with D.A. Davidson & Co., who suggests this may be a kind of elaborate hedge. If energy prices go up, Koch's traditional energy businesses will make more money. If they go down, Georgia-Pacific, a huge energy consumer, will get a lift.

For the rest of the corporate world, there's little choice but to adapt—to Sarbanes-Oxley, to activist hedge funds and to all the other constituencies demanding their due. It's no surprise today's CEOs sometimes seem more like politicians than the autocratic corporate titans of old. Compare General Electric's Jeff Immelt to his predecessor, Jack Welch; or Citigroup's Chuck Prince to his predecessor, Sandy Weill. Or watch the maneuverings of Lee Scott, whose operation at Wal-Mart is taking on some of the trappings of an election campaign.

The unanswered question is whether this heightened corporate accountability makes CEOs perform better...or worse. Mr. Correll apparently believes the answer is worse. "I'm a public-company guy," he said. "I got used to it. But the thought of not being encumbered by that is quite exciting."

Email me at business@wsj.com and read reader comments Saturday at WSJ.com/TalkingBusiness.

QUESTION III.

The Sarbanes-Oxley Act has been discussed in class as a reaction by Congress to the perception and actual wrong-doing of American corporations through their executive offices and boards of directions. Enron, Arthur Anderson, World Com, Health South, and Tyco are only a few companies that are used to illustrate what the public and Congress came to see as a crisis in corporate governance.

You are a summer associate being considered for a full-time associate position in a major law firm. A senior hiring partner has asked you to draft remarks for the hiring committee on the Sarbanes-Oxley Act, Public Law 107-204. A major issue for the firm is whether or not they should advise their publicly held corporate clients to "go private." Specifically, he has asked you to pick ***one*** of the following titles of the Act and to have you comment on why you think it is the most significant title in the body of the Act and its impact on the firm's corporate clients:

Title III Corporate Responsibility

Title IV Enhanced Financial Disclosures

Title V Analyst Conflicts of Interest

or

Title VIII Corporate and Criminal Fraud Accountability

Your remarks may reference appropriate sections of the Act and relevant administrative law regulations in the *Code of Federal Regulations*. Your memorandum is to be concise and to the point.

The text to S-O-X is located in your Statutory Supplement and the text of the *C.F.R.* is on the Internet.