San Luis Obispo College of Law

Business Organizations II

Spring 2025

Professor: K. Gottlieb

General Instructions:

Answer Three (3) Essay Questions.
Total Time Allotted: Three (3) Hours
Recommended Allocation of Time: Equal Time per Question

SLO
Bus. Org II (Corporations)
Spring 2025
Prof. Gottlieb

Exam 1

John, Lisa, and Mark form AlphaTech, Inc. with equal one-third ownership, each contributing $5,000 in startup capital. To fund operations, AlphaTech secures a $2 million business loan from BankCorp, with John personally guaranteeing repayment.

For the first two years, AlphaTech generates moderate revenue, but instead of reinvesting profits, John and Lisa approve substantial salary increases for themselves. They also begin charging personal expenses to the company—John uses company funds to pay his mortgage, and Lisa purchases a luxury vehicle through AlphaTech's corporate account. Mark, a passive investor who occasionally reviews financial statements, notices some questionable expenditures but assumes they are legitimate business costs.

Meanwhile, AlphaTech's financial position worsens, and it struggles to pay creditors. Unbeknownst to Mark, John and Lisa begin transferring AlphaTech's key assets—including its proprietary software and customer contracts—to a new entity, BetaTech, Inc., which they secretly formed and wholly own. BetaTech offers the same products and services as AlphaTech but without AlphaTech's liabilities.

Shortly after the transfers, AlphaTech defaults on its loan, and BankCorp sues to recover the unpaid $2 million. However, AlphaTech is now an empty shell with no significant assets. Mark, after reviewing AlphaTech's financials more closely, discovers the asset transfers and confronts John and Lisa, who claim that they were simply trying to "restructure the business for long-term stability."

Mark, feeling deceived, files suit against John and Lisa for breach of fiduciary duties, while BankCorp seeks to hold John, Lisa, and Mark personally liable for AlphaTech's debts.

Discuss.

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Exam 2

DeltaCorp, a publicly traded company, has been under increasing pressure from shareholders to expand its business and stay competitive in the rapidly evolving tech industry. Seeking to capitalize on new opportunities, CEO Angela and the board of directors approve a $3 billion acquisition of Quantum Solutions, Inc., a smaller tech firm with patented AI-driven security technology.

Prior to the acquisition, an internal due diligence report prepared by DeltaCorp's research division warned that Quantum's patents were likely obsolete and faced significant legal challenges from competitors. The report suggested that an independent financial analysis and intellectual property assessment should be conducted before proceeding. However, Angela and the board chose to rely solely on Quantum's own valuation and revenue projections, which were prepared by Quantum's management and investment bankers.

Following the acquisition, DeltaCorp invested heavily in integrating Quantum's technology, but the anticipated competitive advantages never materialized. The AI-driven security system proved ineffective, and the company's product lines suffered. As a result, DeltaCorp's stock price collapsed by 75%, leading to widespread shareholder unrest.

Meanwhile, it was discovered that CFO Greg had altered financial statements to make DeltaCorp's earnings appear stronger than they actually were in the years leading up to the acquisition. The SEC launched an investigation and charged Greg with securities fraud under Rule 10b-5 for misrepresenting DeltaCorp's financial health.

DeltaCorp's shareholders file suit against the board for its role in approving the Quantum acquisition, alleging a breach of fiduciary duties.

Analyze the potential liability of:

1. The board of directors for its handling of the Quantum Solutions acquisition.

2. Greg for alleged securities fraud under Rule 10b-5.

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Exam 3

OmegaTech, a publicly traded biotechnology company, has been aggressively expanding its operations to secure a competitive edge in the pharmaceutical industry. The company has been negotiating a confidential merger agreement with BioPharma, Inc., a strategic acquisition that is expected to significantly enhance OmegaTech's drug development capabilities and, as a result, increase OmegaTech's stock price once publicly announced.

Rachel, the CEO of OmegaTech, has been deeply involved in the negotiations and is aware that the final deal is nearly complete. Prior to the public announcement, she purchases 10,000 shares of OmegaTech stock, believing that she can capitalize on the expected price increase. She also mentions the upcoming merger to her brother, advising him that "something big is about to happen," and he buys shares as well.

Meanwhile, Sam, a member of OmegaTech's board of directors, has been researching emerging biotech patents that could revolutionize OmegaTech's research and development efforts. While reviewing proprietary market research, he discovers an early-stage biotech patent with significant commercial potential. Rather than informing the board or recommending that OmegaTech pursue the patent, Sam forms his own startup and purchases the patent himself.

Shortly after the merger announcement, OmegaTech's stock price rises sharply, and Rachel and her brother sell their shares for a substantial profit. Separately, Sam's new company begins licensing the biotech patent, generating lucrative contracts with OmegaTech's competitors.

Discuss.

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ANSWER OUTLINE

Exam 1

Issue: Can BankCorp pierce the corporate veil to hold John, Lisa, and Mark personally liable for AlphaTech's debts?

Rule: Courts pierce the corporate veil when (1) there is a unity of interest (alter ego), and (2) recognizing the corporate entity would promote fraud or injustice. Factors include undercapitalization, failure to follow corporate formalities, and diversion of corporate assets.

Application:

- Alter Ego:
- John and Lisa commingled corporate and personal funds (e.g., personal expenses charged to the company).
- AlphaTech was undercapitalized relative to its $2 million debt.
- John and Lisa transferred assets to BetaTech for their own benefit.
- Fraud/Injustice:
- The transfers left AlphaTech unable to pay creditors, harming BankCorp.

Conclusion: A court is likely to pierce the corporate veil and hold John and Lisa personally liable. Mark, however, was a passive shareholder, making it less likely he will be held personally liable.

II. Mark's Claim for Breach of Fiduciary Duties

Issue: Did John and Lisa breach fiduciary duties owed to Mark as a fellow shareholder?

Rule: Officers and directors owe duties of care (prudent decision-making) and loyalty (avoiding self-dealing and usurpation of corporate opportunities).

Application:

- Duty of Care Breach:
- Paying excessive salaries while the company was in financial distress was gross mismanagement.
- Failing to disclose financial issues to Mark prevented informed decision-making.
- Duty of Loyalty Breach:

- Transferring AlphaTech's key assets to BetaTech (a company they controlled) was self-dealing.

- They did not offer the opportunity to AlphaTech, usurping a corporate opportunity.

Conclusion: John and Lisa breached fiduciary duties to Mark. He may seek disgorgement of profits, damages, or reversal of the asset transfers.

III. Fraudulent Transfer Liability

Issue: Can AlphaTech's creditors challenge the transfer of assets to BetaTech?

Rule: Under the Uniform Voidable Transactions Act (UVTA), a transfer is voidable if:

1. It was made without fair consideration,
2. The transferor became insolvent as a result, and
3. It was made to hinder, delay, or defraud creditors.

Application:

- The transfer of AlphaTech's assets to BetaTech was for no legitimate business reason and left AlphaTech insolvent.

- The transfer benefited John and Lisa, while harming creditors.

Conclusion: The court will likely void the transfers, allowing BankCorp to pursue BetaTech's assets.

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Exam 2.

Concise Model Answer (IRAC Format)

I. Board of Directors' Liability for the Quantum Acquisition

Issue: Did DeltaCorp's board breach its fiduciary duty of care by approving the Quantum Solutions acquisition?

Rule: Directors owe a duty of care to act in an informed and prudent manner when making business decisions. The Business Judgment Rule (BJR) protects directors from liability if they act in good faith, with due diligence, and in the corporation's best interests. However, courts may override the BJR if the directors acted with gross negligence or failed to make an informed decision.

Application:

- Failure to Conduct Due Diligence: The board had an internal report warning about Quantum's obsolete patents but chose not to conduct an independent valuation or assess the legal risks of the acquisition.

- Reliance on Interested Parties: The board relied only on Quantum's own financial projections, which were prepared by Quantum's management and investment bankers—both of whom had a vested interest in inflating the company's value.

- High-Risk Decision-Making: A $3 billion acquisition represents a significant corporate transaction, requiring rigorous oversight and evaluation. The failure to examine external valuations and competitive risks suggests a lack of due diligence.

Conclusion: The BJR may not apply, as the board's failure to independently verify material information could be deemed gross negligence, exposing the directors to personal liability for breaching the duty of care.

II. Greg's Securities Fraud Liability Under Rule 10b-5

Issue: Did Greg violate Rule 10b-5 by falsifying DeltaCorp's financial reports?

Rule: Rule 10b-5, under the Securities Exchange Act of 1934, prohibits fraudulent or deceptive conduct in connection with the purchase or sale of securities. To establish liability, the SEC must prove:

1. Material Misrepresentation or Omission (false or misleading statements that would impact investor decisions);

2. Scienter (intent to deceive, manipulate, or defraud);

3. Reliance (investors relied on the false information); and

4. Connection to Securities Transactions (misstatements affected stock prices or trading).

Application:

- Material Misrepresentation: Greg manipulated DeltaCorp's earnings reports to make the company appear financially stronger than it actually was.

- Scienter (Intent to Deceive): If Greg knowingly altered financial data or recklessly disregarded accounting principles, he acted with scienter.

- Impact on Investors: Investors, relying on the inflated earnings reports, may have purchased or retained DeltaCorp stock under false pretenses.

Conclusion: Greg is likely liable for securities fraud under Rule 10b-5 and could face civil penalties, disgorgement of profits, and criminal prosecution.

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Exam 3

Issue: Did Rachel improperly trade on material, nonpublic information (MNPI) and tip her brother in violation of securities laws?

Rule: Under Rule 10b-5 of the Securities Exchange Act of 1934, insider trading occurs when:

1. A corporate insider trades on MNPI in breach of a fiduciary duty; or
2. MNPI is improperly disclosed ("tipping") to someone who trades on the information.

Application:

- Material & Nonpublic Information:
- The pending merger was material because it was likely to impact stock prices.
- The information was not yet public at the time Rachel bought shares.
- Breach of Duty:
- Rachel, as CEO, owed a duty of trust to OmegaTech's shareholders.
- Using MNPI for personal gain violated this duty.
- Tipper Liability (Dirks v. SEC):
- Rachel shared MNPI with her brother, who traded based on her tip.
- If she expected a personal benefit (e.g., helping a family member profit), she is liable as a tipper.

Conclusion: Rachel violated insider trading laws, and both she and her brother may face SEC penalties, disgorgement, and possible criminal liability.

II. Sam's Patent Acquisition and Corporate Opportunity Doctrine

Issue: Did Sam improperly take a corporate opportunity for personal gain in violation of his fiduciary duty?

Rule: A corporate opportunity is one that:

1. The corporation had an interest or expectancy in,
2. Fell within its line of business, and
3. The corporation had the financial ability to pursue.

A director must disclose the opportunity and allow the company to act before pursuing it personally.

Application:

- OmegaTech's Interest in the Patent:
- The patent was in OmegaTech's line of business, and Sam learned about it through his position as director.
- Usurpation of a Corporate Opportunity:
- Instead of offering it to OmegaTech, Sam formed his own company and acquired the patent.
- He profited by licensing it to competitors, directly harming OmegaTech.
- Breach of the Duty of Loyalty:
- A director must act in the company's best interest.
- Sam's conduct was self-dealing, violating his fiduciary duty.

Conclusion: Sam breached his duty of loyalty by usurping a corporate opportunity. OmegaTech may seek rescission, disgorgement of profits, or a constructive trust over the patent.

1)

1. **Mark's suit against John/Lisa for breach of fiduciary duties/Did John and/or Lisa breach their duties to Mark/Are either of them personally liable?**

Mark will have to file a derivative suit on behalf of the corporation to recover from the breach in fiduciary duties of Lisa and John because those duties are owed to the corporation. In a close corporation the shareholders owe the duty of utmost care to each other because it resembles a partnership, however, this duty typically arises in situations of mergers and freezeouts, which is not discussed in the facts. Thus, will not be discussed in the analysis.

FIDUCIARY DUTIES: DIRECTORS AND OFFICERS

A fiduciary is a person who is acting for the benefit of another. Directors and officers manage and run the daily operation of the corporation. They owe fiduciary duties to the corporation of good faith, duty of care, and duty of loyalty to act in the best interest of the corporation.

Here, John and Lisa are both presumably directors of the corporation because there are no facts to suggest there are different board members and this is a close corporation. Further they are both likely officers because they are receiving salaries from the corporation. They are acting for the benefit of the corporation in managing operations. Thus John and Lisa owe a fiduciary duty to the corporation.

DUTY OF CARE: BUSINESS JUDGMENT RULE (BJR)

The BJR sets the standard of care and acts as a shield for directors and officers when making business decisions for the corporation that they will act a a person in a similar situation with reasonably prudent care and on an informed basis. The duty of care is implicated when a director/officer's nonfeasance or misfeasance causes harm to the corporation. Directors/officer's can be held personally liable when their conduct falls below the standard of care, BJR. Generally, the court will refrain from reviewing business decisions unless there are allegations of fraud. The BJR does not apply to fraud/conflict of interest situations.

Here, on the issue of John/Lisa approving a substantial salary increase for themselves, this is a conflict of interest because they are receiving the salary as officers and approving the salary as board members which is an interest director transaction. This business decision is not shielded by the BJR. Therefore the decision to increase their salaries, despite the moderate revenue of an undercapitalized company,

will be fully reviewed by the court for a conflict of interest.

DUTY OF LOYALTY: CONFLICT OF INTEREST

A director or officer owes a duty of loyalty to the corporation of acting reasonably and *on an informed basis* in the best interests of the corporation when making business decisions. The duty of care is implicated when a fiduciary director/officer has a conflict of interest. Breach typically falls under the categories of self dealing, competing ventures, and usurpation of corporate opportunity.

Self Dealing

Self dealing involves an interested director or officer that is on both sides of the transaction. Here, Lisa/John are on both sides of the transaction that approved a substantial salary increase. That salary increase seems unreasonable and uninformed because the corp. is already under capitalized, the corp has only been turning profits for about 2 years--not enough time to determine how the next couple years will be financially, and because there is nothing in the facts to suggest how John/Lisa made this decision to increase the salaries. It might be informed , however on these facts, there is no information to demonstrate informed decisions. The corporation is likely undercapitalized because the shareholders only put in $15,000 and then immediately borrowed $2 million. Thus the decision is uninformed and unreasonable.

Competing Ventures

Competing ventures is when an officer or director going into competition with their own corporation.

Here, John and Lisa have formed BetaTech, which is a competing company to AlphaTech because it offers the same products and services as AlphaTech. Thus this is a competing venture.

Usurpation of Corporate Opportunity

Usurpation occurs when a director/officer wrongly takes an expected corporate opportunity for oneself.

Here, John and Lisa have usurped a corporate opportunity because they took the key assets and customer contracts and proprietary software. Thus they have usurped a corporate opportunity.

DEFENSES FOR JOHN/LISA:

Approval by a disinterested board, approval by the share holders, transaction was fair to the corporation.

There are no facts to suggest any of these defense are present.

CONCLUSION: Mark will be able to hold Lisa and John personally liable for breach in fiduciary duties.

2. **May BankCorp hold John, Lisa, and Mark personally liable for AlphaTech debts?**

PIERCING THE CORPORATE VEIL (PCV)

Generally, shareholders are not personally liable for the debts of the corporation. However a court may disregard the corporate form and pierce the corporate veil (PCV) to hold shareholders personally liable in certain circumstances, typically closely held corporations, when the shareholders act improperly for actions such as alter ego, undercapitalization, and fraud.

John and Lisa will be personally liable for the corporate debt but Mark may avoid liability because there are no facts to suggest he used the corp as an alter ego, or commit fraud. It's possible that Mark may be liable under undercapitalization, but his lack of intent to abuse the corporate form is a likely a good defense for him given the egregious actions of John and Lisa that harmed Mark too.

Close Corporation

A close corporation is one with few shareholders that is not publicly traded.

Here, AlphaCorp is a closely held corporation because it has 3 shareholders and is not publicly traded. Thus it is a closely held corp.

Alter Ego

When the shareholders treat the corporation as an extension of themselves and ignore the corporate form, commingle accounts and assets, etc.

Here, Lisa and John are treating the corporation as an extension of their personal selves becuse they are commingling funds, buying luxury cars and houses with corporate assets, and charging personal

expenses to the company. This is not respecting corporate formalities or keeping records straight and they are using it as an extension of themselves in their personal lives. Thus John and Lisa used the corp as their alter ego.

Undercapitalization

When the corporation is not funded appropriately to meet its foreseeable corporate obligations it is undercapitalized.

The fund is under capitalized for the reasons discussed above, the $15,000 initial investment and then the $2 million loan = likely under capitalized because that is a huge discrepancy. Thus the corp is undercapitalized.

Fraud

Fraud is where there is intent to misuse the corporate form to commit fraudulent acts such as avoiding creditors.

Here, AlphaCorp was likely set up by at least knowingly by John and Lisa as an intended shell company as a way to defraud creditors and fund BetaTech because the assets likely used by AlphTech to secure the loans from BankCorp were almost immediately transferred to BetaCorp. Further fraud discussion below. Thus the shareholders used the corp to commit fraud.

CONCLUSION: Yes, the corporate veil can be pierced to pay back Bankcorp for the $2 million loans.

BANKCORP REMEDY: FRAUDULENT TRANSFER/VOIDABLE CONVEYANCE

Voidable if done with the actual intent to hinder, avoid, or defraud creditors. It is designed to protect creditors' interests.

John at least clearly created AlphaTech as a way to defraud creditors because he personally guaranteed a $2million dollar loan that he coudl likely never repay. John and Lisa then transfered money (which is mostly the loan money from BankCorp) from AlphaTech to BetaTech, making Alpha Tech a shell company--with the liabilities of debt but no funds. This is exactly the type of fraud on creditors that the voidable conveyance doctrine was designed to protect because BankCorp cannot collect from an empty company. Thus, the transfer to BetaTech will be voidable.

2)

Liability of Board of Directors - Quantum Solutions Acquisition

Directors owe fiduciary duties to the corporation and its shareholders including the duty of loyalty, care and disclosure.

Duty of care:

Directors owe a duty of care to the corporation to act in good faith, as a reasonably prudent person would, and to act in the best interest of the corporation. Part of the duty of care includes the business judgement rule.

Business Judgement Rule: The business judgement rule (BJR) is the standard of care applied to a directors business judgement. Directors are presumed to act in good faith and their business decisions are generally not reviewed by the courts absent a showing of unreasonable behavior, fraud, or illegality. Directors can rely on outside information prepared by a committee, accountant or other person the director believes to be competent. A director will not be held liable for a business decision that turns out to be bad, or less profitable than anticipated if they relied on outside information they believed to be reliable.

Here, CEO of DeltaCorp (DC) and the board of directors approved an acquisition of Quantum Solutions (Quantum). While the acquisition was pending DC's research division prepared a due diligence report flagging issues with Quantum's patents, and that Quantum faced legal challenges from competitors. The diligence report also called for an independent intellectual property assessment and financial analysis be conducted before proceeding. However, Angela and the board of directors chose to rely solely on Quantum's internal report prepared by Quantum's managers and investment Bankers that contained revenue projections and the company's valuation. The board of directors and Angela did not act in good faith or exercise sound business judgement as a reasonably prudent person would in their situation because they had information that raised significant legal questions and financial issues with Quantum. The board of directors could have, but did not seek an independent analysis or an outside opinion. By relying on Quantum's reports the board and CEO risked relying on biased information and did not due their due diligence before approving the acquisition. Additionally the board did not seek an independent valuation of Quantum before acquiring the company. This directly affects shareholders because their shares could be weakened as a result of an inaccurate valuation of a

subsidiary company. Shareholders have a right to object to the acquisition/ merger. However, only close corporation shareholders have a right to demand an appraisal of their shares which requires the corporation to cash them out at fair market value, DC is a publicly traded corporation and this is not available to DC shareholders.

The board and CEO can argue they used their business judgement, and reasonably believed that Quantum's information was reliable and prepared by competent people. Absent a showing of fraud, illegality or unreasonable conduct the BJR will apply. Although the DC company's stock price fell 75% after the acquisition and DC's product lines suffered, the board and CEO can claim they relied on Quantum's information in their business judgment to approve the acquisition. The board and CEO can argue that they should not be held liable for a business judgment that resulted in bad business, lost profits or an unfavorable result for shareholders. However failing to obtain an independent valuation of a company before paying $3 billion is highly unreasonable, and any board member or CEO in a similar situation would not move forward without an independent evaluation, especially for such a high price ($3 Billion).

Conclusion: A court will likely hold the board of directors and CEO liable for breaching the duty of care to the corporation. A court will likely find the board and CEO's behavior unreasonable and disregard the BJR to hold them personally liable for business debts.

Duty of Disclosure:

Directors and officers must disclose material information to other members of the board and the corporation's shareholders. Information is considered material if a shareholder would use that information to inform their decision to trade or invest.

Here the board of directors and CEO, knew that DC's diligence report raised serious issues that would affect a shareholders decision to trade, including: Quantum's patents possibly being obsolete, and Quantum facing significant legal challenges from competitors indicating possible fraud or stolen intellectual property.

Greg's Liability for alleged Securities Fraud under Rule 10b-5

Rule 10b-5 Insider Trading and Securities Fraud:

Rule 10b-5 prohibits any intent to defraud fraud, misrepresent or omit material information connected to the the trading of any security, by an instrumentality of interstate commerce. Use of nonpublic

material information to trade securities is prohibited.

There must be an intent to commit fraud, misrepresentation or omission, a sale or purchase of securities, reliance on the misrepresentation or omission in the transaction, an instrumentality of interstate commerce like a securities market and damages.

Here, the CFO of DC, Greg, misrepresented DC's financial statements by altering them to make DC's earnings appear stronger than they actually were. Greg intentionally misrepresented omitted the true financial health of DC because he wanted the earnings to appear stronger for the upcoming acquisition. The acquisition is a purchase of securities because DC acquired Quantum's stock, DC is a publicly traded company and while there are no facts describing how the acquisition took place we can assume it was through a securities exchange market which is an instrumentality of interstate commerce. It is likely that the board and CEO relied on Greg's misrepresentations to move forward with the acquisition. DC sustained damages of losing 75% of its stock price and the company's product lines suffered.

DC can seek to remedy their damages by in the amount of the difference of what they paid and the actual value of the Quantum.

Conclusion: A court will likely find that Greg met all elements of rule 10b-5 and hold him personally liable for DC's damages.

3)

Rachel and her Brother's Issues

Rule 10b-5 Violations: Insider Trading and Securities Fraud

Rule 10b-5 prohibits any intent to defraud , misrepresent or omit material information connected to the the trading of any security, by an instrumentality of interstate commerce. Use of nonpublic material information to trade securities is prohibited.There must be an intent to commit fraud, misrepresentation or omission, a sale or purchase of securities, reliance on the misrepresentation or omission in the transaction, an instrumentality of interstate commerce like a securities market and damages. Rule 10b-5 violations can occur through: Insider trading, misappropriators, tippers and tippees.

Insider Trading

Insider trading occurs when classic corporate insiders such as directors, shareholders or officers trade on nonpublic material information. Information is considered material if a shareholder would rely on the information in deciding how to trade.

Rachel is the CEO of OmegaTech (OT), she has been deeply involved in negotiations for a confidential merger. Rachel has access, as an officer, to important information that has not yet been disclosed to the public because she is negotiating on this confidential merger. Before OmegaTech (OT) publicly announced its merger, she buys 10,000 shares of OT stock because she believes its stock price will rise significantly after the merger is announced to the public. Rachel has defrauded other investors by trading on nonpublic information when she purchased 10,000 shares of OT. It is likely she purchased these shares on a securities exchange because OT is a publicly traded company, which means she used an instrumentality of interstate commerce. As a result, Rachel could be required to disgorge all of her profits back to OT.

Tippers

A tipper is one who provides nonpublic material information to another person. Tippers can be held liable even if they themselves do not buy or sell securities, as long as the person they tipped off does.

Rachel tipped off her brother by telling him about the upcoming merger and advising him that "something big is about to happen." Rachel's brother also buys shares of OT. Rachel was privy to

material nonpublic information because she is the CEO of OT, and was participating in negotiations for a confidential merger. Rachel's brother purchased his shares before the merger was announced to the public.

Rachel can be held liable for insider trading as a tipper.

Tippees

A tippee is one who uses material non-public information to buy or sell securities. Tippees are not classic insiders such as officers or directors of a corporation but are usually tipped by an insider.

Rachel's brother is not employed by OT and does not serve as a director or officer, he is also not a shareholder. Rachel has provided her brother with material nonpublic information by telling him about the merger before it was publicly announced and by advising him that "something big is about to happen." As a result, he decides to buy shares of OT stock. He can be required to disgorge any profits he made from the purchase back to OT.

Rachel's brother can be held liable for trading as a tippee.

Sam's Issues

Director's Fiduciary Duties

Directors owe fiduciary duties to the corporation including the duty of care, loyalty, disclosure, and the duty not to waste corporate assets.

Duty of Care

Directors owe a duty of care to the corporation to act in good faith, as a reasonably prudent person would, and to act in the best interest of the corporation. Part of the duty of care includes the business judgement rule.

Sam is a member of OT's board of directors. While reviewing proprietary (OT's property) market research he has discovered a new patent with significant commercial potential and he decides not to inform the board to pursue the patent. As part of Sam's duty of care to OT he has a duty to disclose material information to other members of the board. By failing to inform the board of his research

findings, he has breached the duty of disclosure. Sam has also acted in his his own interest by deciding to purchase the patent himself. Sam has not acted in the best interest of the corporation, which is a breach of the duty of care.

Business Judgement Rule: The business judgement rule (BJR) is the standard of care applied to a directors business judgement. Directors are presumed to act in good faith and their business decisions are generally not reviewed by the courts absent a showing of unreasonable behavior, fraud, or illegality.

Sam has likely engaged in illegal activity by failing to disclose the biotech patent to the board of directors and by acting in his own interest (discussed fully below). If a court finds that Sam has acted unlawfully and not in the best interest of the corporation, the court may not extend the business judgment rule to Sam's conduct. The court can hold Sam personally liable for any business debts due to his conduct.

Duty of Loyalty

Directors owe a duty of loyalty to the corporation to not profit at the corporations expense, this includes usurping a business opportunity, unfairly competing with the corporation, or engaging in conflicted interest transactions. Shareholders do not owe a duty of loyalty to other shareholders.

Usurping a Business Opportunity

A director usurps a business opportunity when they fail to present the opportunity to the corporation before taking it for themselves, and the corporation has a business expectancy or interest, meaning the corporation would expect to be presented with the opportunity.

Sam is a director of OT. Sam has discovered a potentially lucrative patent and failed to disclose this to OT's board of directors before purchasing the patent himself with his own start-up company. The patent is a biotech patent that would revolutionize OT's research and development, and the patent has significant commercial potential. OT has a business interest in this lucrative biotech patent because it could revolutionize its research and development. It is likely that OT would expect its directors to present it with any business opportunities in OT's line of business, like the patent that Sam, a director of OT, has discovered. By forming his own startup and purchasing the patent without first offering the patent to OT, sam has breached the duty of loyalty and usurped a corporate business opportunity from OT.

Sam may be able to remedy this breach if: a majority of disinterested board members authorize his purchase of the patent after Sam discloses all material information, or a majority of shareholders approve of Sam's purchase after material disclosures have been made AND the transaction is fair to the corporation.

It is very unlikely that Sam's purchase of this patent is fair to the corporation, and unlikely that the board or shareholders will approve after they learn all material information about the biotech patent.

Unfair Competition

A director who unfairly competes with the corporation has breached their duty of loyalty.

Sam is a director of OT. He has formed his own startup to purchase a biotech patent he discovered using proprietary OT research. This purchase nor the patent discovery was not disclosed to the board of OT or to its shareholders. Sam has also not disclosed his new startup to the board or to OT's shareholders. After Sam's new company begins licensing the biotech patent, it begins generating lucrative contracts from OT's competitors. Sam is competing directly with OT by obtaining lucrative contracts from OT competitors. This was done unfairly because Sam is able to compete as a result of usurping a corporate opportunity (discussed above) by purchasing a biotech patent, while maintaining his role as a director of OT, without offering it to OT first. As a result Sam is profiting from his new startup and biotech patent purchase. This is unfair to OT, and Sam can be required to disgorge all of his profits and contracts with competitors to OT.

Conclusion: Sam has engaged in unfair competition with OT, and likely will be required to disgorge all profits.

END OF EXAM