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Business Associations
The University of North Dakota School of Law
Fall 2016
Kit Johnson, Associate Professor of Law

FINAL EXAMINATION: PART TWO

Notes and Instructions

1. The total duration of Part Two of this exam is two hours and forty minutes.
2. The first 30 minutes of Part Two is a reading period. **You may not begin typing or entering into bluebooks any response during this first half hour.** This is your time to carefully read the question(s) and organize your thoughts about how to respond. During the reading period you may: make notes on this exam sheet and/or scratch paper; reference notes and materials and make notes thereon; outline your response on scratch paper (which I encourage). Marks or notes made during the reading period will not be evaluated or counted for your grade. Note that only your response recorded in the proper place (ExamSoft or bluebooks) will be graded.
3. Part Two is an open-book exam. You may use any notes or books you like. You may not use or reference electronic or interactive resources including, but not limited to, the internet, iPads, tablet computers, cell phones, or any other digital device or network. You may, of course, use a laptop to write your exam, but you may not reference files stored thereon during the examination session.
4. **Do not turn the page until instructed to begin.**
5. You may be denied credit for this portion of the exam if you do not return this booklet at the end of the period with your exam number written above.
6. Your goal is to show your mastery of the material presented in the course and your skills in analyzing legal problems within the scope of the course's subject matter. It is upon these bases that you will be graded.
7. During the exam: You may not consult with anyone – necessary communications with the School of Law staff being the exception. You may not view, attempt to view, or use information obtained from viewing other student examinations or from viewing materials other than those you brought in.
8. After the exam: You may not communicate regarding the exam with any enrolled member of the class who has not yet taken the exam, and you must take reasonable precautions to prevent disclosure of exam information to the same.
9. You may not copy, transcribe, or distribute the material in this booklet or attempt to do the same.
10. Base your exam answer on the general state of U.S. law, including statutes and cases discussed in class.
11. Organization counts.
12. Keep in mind: The weight given to each part is specified, but not all issues within each part will be given equal weight. Thus, it may be entirely appropriate for one issue to be dispensed with considerable brevity, while another might require very detailed analysis. You should divide your time according to which issues require the most discussion and analysis.
13. **Bluebooks:** Make sure your handwriting is legible. I cannot grade what I cannot read. Skip lines and write on only on one side of the page. Please put answers to each section in a separate blue book and label the blue books accordingly. Please write in pen using blue or black ink.
14. **Computers:** Please clearly label your answers to each subpart, starting a new "question" in ExamSoft for each subpart.
15. Do not write your name on any part of the exam response or identify yourself in any way, other than to use your examination I.D. number appropriately. Self-identification on the exam will, at a minimum, result in a lower grade, and may result in disciplinary action.
16. Good luck.

Amy Arbunkle, Chip Cheswick, and Darrell Deerlington met on the first day of ninth grade when they were assigned to be lab partners in Mr. Zelwick's Advanced Biology class. They formed the sort of bonds that can only be forged among teenagers dissecting formaldehyde-infused frog corpses.

Amy, Chip, and Darrell stayed tight through high school and college. After college, they found themselves working dead-end jobs in their hometown of New Michisota City, Michisota. But the three dreamed of bigger and better things.

One night, the three pals were drinking craft beer and spitballing about the future when they came up with a brilliant plan: The Beard Barn. The Beard Barn would offer a "beard grooming experience" in downtown New Michisota City that would evoke a rural Michisota barn. The walls would be wood, the staff accoutered in flannel, the smell of pine would permeate the air, and the service would be one of a kind.

Surprisingly enough, in the sober light of the following morning, The Beard Barn still sounded like a good idea. So Amy, Chip, and Darrell decided to pursue it.

They started by pooling their resources. Amy contributed \$5,000 from her savings. Chip contributed \$500, and he worked with his father, a real estate agent, to find a home for The Beard Barn among the brightly-painted shops of Broadpark, an up-and-coming section of New Michisota City beloved by tourists and locals alike. Darrell didn't have any money to contribute, but he was handy with a saw, and he adapted the Broadpark retail space to match the friends' vision for The Beard Barn.

In no time at all, The Beard Barn was open for business. Amy took it upon herself to hire Franklin Freestand to serve as The Beard Barn's first full-time trimmer. Chip served as the onsite store manager overseeing day-to-day operations. The three friends met twice a week to discuss the ins and outs of their fledgling business.

The Beard Barn was not an instant success. Amy, Chip, and Darrell had difficulty meeting their financial obligations at first. For example, Franklin ordered a case of beard balm from Everything Eucalyptus for the store. While Chip was the principle purchaser for The Beard Barn, Franklin ordered the balm without consulting Chip because, as he told Chip when the bill came in (and after he'd already used a third of the product ordered), "no true beard aficionados would deign to be balmed with anything less than Everything Eucalyptus." The problem was that The Beard Barn barely had enough revenue coming in to cover rent and Franklin's salary. It couldn't pay Everything Eucalyptus. Soon enough, Everything Eucalyptus filed a suit against The Beard Barn, Amy, Chip, and Darrell. The lawsuit ended up in front of Judge Jimmy Jagerson where it has been sitting in limbo due to a lengthy docket backlog.

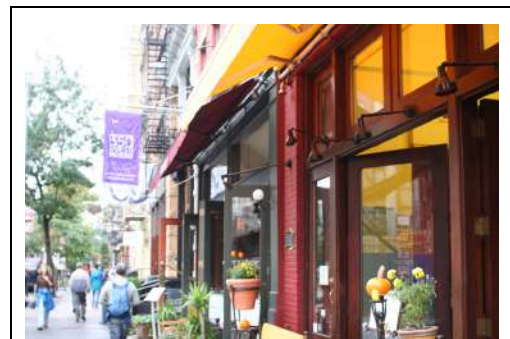


FIG. 1: The Beard Barn took over space that was next door to a successful jewelry store and previously occupied by Thimbles-N-Such, an enterprise that had gone out of business after just three months in Broadpark.

Photo: Eric E. Johnson

After more than six months in business, The Beard Barn finally started to turn a profit. And that's when luck really struck. The Beard Barn was spotlighted in *Wings*, the in-flight magazine for regional airline Western Winds. The *Wings* profile featured beautiful photographs of The Beard Barn's unique interior and called the shop the number one spot for bearded visitors to New Michisota City.

Howard Haliday, bearded billionaire investor, was flying into New Michisota City on Western Winds when he read the profile of The Beard Barn in *Wings*. He decided to swing by.

After Howard experienced The Beard Barn for himself, he knew that it was a potential goldmine. He met with Amy, Chip, and Darrell to talk about taking The Beard Barn nationwide.

After consulting with lawyers, Howard, Amy, Chip, and Darrell formed Gentleman's Grooming Garage Incorporated ("GG"), a publicly traded Delaware corporation with 10,000 shares outstanding. Howard held 5100 shares, and Amy, Chip, and Darrell each held 300 shares, while the remaining 4000 shares were purchased by various individuals nationwide. Amy, Chip, and Darrell became three of the company's first five directors as well as its CEO, CFO, and Vice President of External Affairs respectively. They were joined on the board of directors by company outsiders Irwin Inskip and Kate Kratchett.

The articles of incorporation filed on behalf of GG included the following provision:

ARTICLE TWELFTH. TO THE FULLEST EXTENT PERMISSIBLE BY LAW, A DIRECTOR OF THIS CORPORATION SHALL NOT BE LIABLE TO THE CORPORATION OR ITS STOCKHOLDERS FOR BREACH OF FIDUCIARY DUTY.

With its founding document and key personnel in place, GG got down to business: opening specialty grooming garages in urban centers around the United States.

Three months into the GG venture, Darrell went out to dinner with Merisa Mendholson, CEO of Limeny Liniments, a key supplier of beard oils and waxes to GG. Darrell wanted to negotiate a long-term contract with Limeny Liniments to reduce the prices GG paid for their supplies, and he reached a profitable agreement with Merisa. Business concluded, the pair talked about a range of other things over dessert. It turned out that both felt there was an unmet need in the current market for organic fair-trade neckties. Darrell and Merisa decided to go into business together and soon launched Neo Neckwear LLC as a manager-managed LLC with Merisa as the company's manager.

When Howard learned about Neo Neckwear, he was not pleased. He vowed to do everything in his power to replace Darrell on the GG board of directors at the next shareholders meeting and to get Darrell fired from his position as Vice President of External Affairs. He demanded that GG include his call to action against Darrell in its next proxy statement. Howard also demanded access to any and all documents concerning GG's strategic

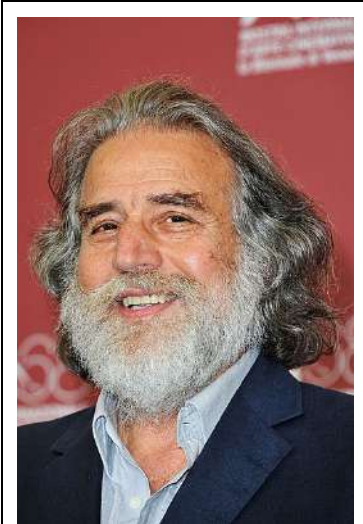


FIG. 2: Howard Haliday was known as much for his adventurer lifestyle as his wide-ranging investments.

Photo: Alessandro Striggio, [Mimmo Cuticchio](#), CC BY-SA 4.0, via Wikimedia Commons

planning efforts to assess the extent to which GG was considering moving into the neckwear market.

Soon after the Neo Neckwear scandal broke, GG discovered that managers at two different GG grooming locations (in Memphlanta and Georgolina) had worked together to steal the \$5 million in development funds GG had set aside for the creation of new stores. What's worse, GG wasn't the one to uncover the scandal. The company hadn't even noticed the monies were missing until a disgruntled ex-girlfriend of one of the managers reported the scheme to local police who, in turn, blew the conspiracy wide open. When the news broke of the managers' embezzlement, GG stock took a steep dive.

Trying to regroup from this financial setback, the board of directors set out to determine if there had been any warning signs of embezzlement. They uncovered a memo that had been sent to the entire board written by Tamany Twickett, Chip's assistant. The memo identified material weaknesses in GG's financial controls, stating, among other things, that there was inadequate supervision of the development funds. Tamany sent her memo by an e-mail in which Chip was the only primary addressee (i.e., he was the only recipient in the "To:" field), and other members of the board of directors were cc'd (i.e., their e-mail addresses were in the "Cc:" field). It turns out that it was common practice on the board for directors to only read those e-mails that were directly addressed to them, assuming that when they were cc'd on a matter, the board member to whom the e-mail was formally addressed would take the lead on addressing the issues raised. Chip, for his part, was awash in e-mail. Tamany's memo was buried in an inbox that contained 45,000 unread messages.

Howard had enough. Without consulting anyone at GG, Howard filed suit on behalf of himself and GG against Amy, Chip, Darrell, Irwin, and Kate in Delaware's Court of Chancery.

One week later, Amy collapsed at work and was rushed to the hospital. Doctors diagnosed her with reactive hyperplasia. Amy had been wearing a recently-purchased black vegan Neo Neckwear original necktie, and the doctors determined that despite its organic label, the tie was saturated with nonylphenol ethoxylate, trichloroethylene, and *p*-Phenylenediamine, carcinogenic chemicals that caused Amy to go into anaphylactic shock. Amy consulted a retired trial lawyer who'd made a whole career out of defective products litigation. He assured Amy that she has a solid personal injury claim in tort. But the question is who could pay a judgment. Neo Neckwear LLC is not much more than a corporate shell. It doesn't have enough cash in hand to compensate Amy for her medical expenses. Amy is reluctant to seek compensation from her good friend Darrell, but she's interested in learning whether she can access Merisa's deep pockets.

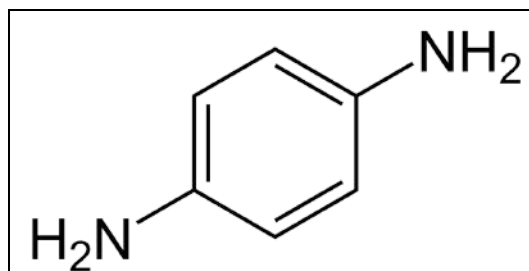


FIG. 3: *p*-Phenylenediamine or PPD is a chemical substance widely used in hair dye. It is also used to dye textiles black. It was declared the Contact Allergen of the Year for 2006 by the American Contact Dermatitis Society (ACDS).

Image: RicHard-59, [Chemical structure of p-phenylenediamine](#), Public Domain, via Wikimedia Commons

QUESTION

Analyze the parties claims, duties, and liabilities in light of the above facts. Please organize your response as follows, clearly labeling the subparts:

- Subpart A: Discuss the Everything Eucalyptus litigation.
- Subpart B: Discuss Darrell's involvement with Neo Neckwear. Subpart C: Discuss Howard's initial response to the Neo Neckwear situation.
- Subpart D: Discuss the embezzlement of GG's development funds.
- Subpart E: Discuss possible procedural challenges to Howard's lawsuit.
- Subpart F: Discuss Amy's potential suit against Merisa.
- Subpart G: If there is anything else you wish to discuss, which does not belong in any of subparts A through F, please put it under this Subpart G.

Keep in mind the subparts will not be given equal weight. The subpart structure is provided for organizational purposes only. It may be entirely appropriate for one subpart to be answered with considerable brevity, while other subparts might require very detailed analysis. Pace yourself appropriately, and plan ahead to put information where it belongs.

Finally, avoid needless repetition. Do not repeat the exact same analysis with substituted parties. You may incorporate analysis by reference to another portion of your exam answer to the extent appropriate.

Some suggested abbreviations for your answer:

AA:	Amy Arbunkle	II:	Irwin Inskeep
BB:	The Beard Barn	JJ:	Judge Jimmy Jagerson
CC:	Chip Cheswick	KK:	Kate Kratchett
DD:	Darrell Deerlington	LL:	Limeny Liniments
EE:	Everything Eucalyptus	MM:	Merisa Mendholson
FF:	Franklin Freestand	NN:	Neo Neckwear LLC
GG:	Gentleman's Grooming Garage, Inc.	TT:	Tamany Twickett
HH:	Howard Haliday	WW:	Western Winds

END OF EXAMINATION