EXAM NUMBER _______

TITLE OF COURSE: Corporations

INSTRUCTOR'S NAME: Klick

DATE OF EXAM: December 14, 2007

LENGTH OF EXAM (Hours Not Pages): 3 hours

INSTRUCTIONS (Please be very specific.)

This is an open-book, open notes exam. You may use any personally prepared or purchased supplemental materials in the completion of this exam. You may not access the Internet during the exam.

Each of the four questions (including subparts) is worth 25 percent of the total grade, and you may allocate your time as you see fit.

If any question appears to be ambiguous, please make (and describe in your answer) any reasonable assumptions necessary to complete your answer.

Good luck.

1. Andy Reid serves as head coach and executive vice president of football operations for the Philadelphia Eagles. In these positions, he has decision-making authority over all football aspects of the team, though he has no authority over the business aspects of the organization (and is very rarely even consulted on these issues). He is additionally the father of Britt and Garrett Reid, two adult sons who live in Reid's personal residence in Delaware County, Pennsylvania. Britt and Garrett have each served jail terms related to various drug and weapons charges.

In an attempt to put his sons on the straight and narrow, Andy Reid decides to use them as "coach's helpers," using them to relay messages to players, to help with clerical tasks, to serve as "go-fers," etc. Andy Reid believes that by putting his sons in this position, he will be better able to monitor their behavior, and he believes that the extensive contact with disciplined athletes will be good for his sons' development. While the sons receive no official paycheck for their duties, Andy Reid tells them that they must serve in this role if they want to continue living in his home, have use of the family cars, etc. At no time are Britt and Garrett employees of the Eagles organization, though they often eat meals with players in the Eagles facilities without being asked to pay and they have virtually unlimited access to team facilities, including player locker rooms, practice facilities, coaches' offices, etc.

Andy Reid does not seek approval from anyone in the Eagles organization with respect to using his sons as coach's helpers, though he does not hide the fact from anyone either. That is, many individuals in the Eagles hierarchy, including the team owner (Jeffrey Lurie) and the team president (Joe Banner), know about Britt and Garrett's past troubles and their new role as coach's helpers, since these individuals are often present at Eagles practices and they observe Britt and Garrett delivering messages, equipment, and various other miscellaneous items between coaches and players.

After the Eagles starting quarterback goes down with an ankle injury in an early season game, Britt and Garrett, worried about their father's chances of winning without the starting quarterback, provide the player with various unlabeled drugs, including many found on the NFL's "banned substances" list. The quarterback asks Britt and Garrett whether the drugs were prescribed by the team physician. The coach's helpers answer "yes." Skeptically, the quarterback asks them "What is all this stuff?" Britt answers, "It'll fix you up."

After three weeks of using Britt and Garrett's medications, the quarterback tests positive for multiple banned substances under the NFL's drug policy. Because this player had violated the policy a number of times before, he receives a lifetime ban from playing with any NFL team in the future and forfeits the money remaining on his Eagles contract, amounting to $30 million.

During this same period, in the wake of a few high-profile incidents where professional football players were the targets of violent crimes, one of the Eagles players asks Britt and Garrett about obtaining a handgun for personal protection. The player is barred from purchasing any firearm in Pennsylvania himself due to a series of convictions for domestic violence in his background. Britt and Garrett obtain an unregistered handgun for the player which he keeps in his duffle bag for protection. On the way into the following week's game, as the player searches for something in his bag, the handgun falls out of the bag on to the ground. Security guards at Lincoln Financial Field, the home stadium for the Eagles, alert NFL officials about this violation of the NFL's gun policy which prohibits any player from possessing a firearm at a game site. In accordance with the gun policy, the NFL fines the player 1/3 of his salary for the season.

Both of these players attempt to sue the Philadelphia Eagles organization for lost wages resulting from the drug and gun violations.

1.a Based on the information provided here, discuss the most plausible theories of liability for the Eagles with respect to both claims.

1.b Based on the information provided here, discuss the Eagles' possible defenses.

2. FSU Corporation is a Delaware corporation engaged in developing fuel cell technology for automobiles. Given rising gasoline prices and the prospect of stricter fuel economy standards and/or carbon taxes, FSU's stock price has been soaring. In recognition of this stock appreciation, FSU's board approves a grant of significant stock options to senior managers and executives. In accordance with SEC rules, this grant is approved by a shareholder vote by a wide margin on December 14, 2007.

The particulars of the stock option grant are as follows: Each person receiving the grant, including the CEO, president, vice presidents, and executives above the director level, will receive 10,000 call options with the strike price (i.e., the price at which the individual can purchase FSU shares) set equal to the market closing price on January 4, 2008. There are no sale restrictions on the options (i.e., the holders may exercise the options at any point after January 4, 2008).

On January 3, 2008, FSU's chief research scientist discloses to FSU's CEO and president, in a private meeting, that the big breakthrough they had been waiting for might have happened. Namely, FSU's R&D group has developed a cost-effective technology allowing for fuel economy in excess of 200 miles per gallon in a standard size car. While the technology still needs to be tested on a larger scale, the scientist estimates a 30 percent likelihood that they can bring the technology to market within the next two years based on the first round of testing.

On January 4, 2008 (a Friday), after the market closes, the scientist again meets with the president and CEO and indicates that his initial estimate was too conservative. He states that the consensus estimate (regarding bringing the technology to market within two years) of the researchers is now closer to 90 percent.

FSU holds a large press conference on the morning of Monday January 7, 2008 to describe the breakthrough and quotes the scientist's 90 percent estimate. FSU share price more than doubles relative to Friday's closing price even though the market as a whole exhibits little movement that day. This higher price endures through the rest of the year. All individuals receiving the options described above immediately exercise those options and then sell the associated FSU stock in August of 2008, making a substantial profit.

2.a You represent Warren Buffet, a large shareholder in FSU. Buffet asks you to craft a legal claim outlining grounds for the CEO and president (and perhaps the others receiving the option grant) to disgorge the profits they made by exercising the options they were granted.

2.b You represent the CEO and president. Outline your defense to the claims made in 2.a above.

3. A number of commentators (e.g., Michael Jensen, past president of the American Finance Association, and Frank Easterbrook, lecturer at University of Chicago Law School and federal Court of Appeals judge) have suggested that dividend payments serve to reduce agency costs. Given the (until recently) large differential tax disadvantage to dividend payments versus capital gains generated by the firm retaining earnings, it is a bit of a puzzle as to why firms paid dividends at all, since shareholders could have always created their own dividends by simply selling some of their shares. The Jensen/Easterbrook free cash flow hypothesis suggests that managers of cash-rich firms (i.e., firms that hold on to excess revenues and do not pay them out in dividends) face little monitoring and discipline with respect to their spending on new projects relative to those firms that pay out cash dividends whenever revenues allow for such payments.

3.a Provide a logical rationale for the free cash flow hypothesis.

3.b In what ways does the logical validity (theoretical consistency) of the free cash flows hypothesis depend crucially on one's view of how efficient (informationally and/or allocatively) capital markets are?

4. Choose one of the previous three questions (and subparts) to count double in determining your grade or choose to have each count for 4/3 toward the determination of your final grade (i.e., have each of the three questions count equally). Make sure your choice is clearly identified or else you will simply lose 25 percent of the total points available in the exam.