

CALIFORNIA

BAR

EXAM

Intensive Testing Day #2
THREE ANSWERS

QUESTION ONE

TITLE: DIRECTOR-OFFICER-LAWYER - SECURITIES LAWS
SUBJECT: CORPORATIONS
FILE: CORP03J.ANS

I ACTIONS WHICH VIOLATED FEDERAL SECURITIES LAWS

January 2: Corp announced that it expected a 25% increase in revenue.

This announcement is not an action by Director, Officer, or Lawyer. Also, it does not constitute a violation of federal securities laws if the announcement was truthful and not misleading.

March 1: Director sold 1000 shares at \$25 each. It is not a federal securities violation for a Director to sell shares. However, it is a violation of 10b-5 to trade based on undisclosed inside information; and it is a violation of 16(b) for a director to buy and sell, or sell and buy, within six months of each other.

A. Violation of 16(b)

Clearly, 16(b) has not been violated at this time because there has been only one transaction by Director

B. Violation of 10b-5

Section 10b-5 was probably not violated but it is not as clear. Director may have used inside information at this time. For example, it is possible that Director realized on March 1 that the 50% decrease in revenue was inevitable, although the corporation did not learn of this until three months later, June 15. If so, this trade violated 10b-5. Director failed to disclose the inside information, the information was material because a reasonable trader would have wanted to know this, and Director sold 1000 shares so the transaction was probably made over a national exchange, satisfying the jurisdiction requirement of 10b-5.

On the other hand, Director may have realized, along with the general public, that the stock increase caused by the announcement on January 2 had reached its maximum and the stock should probably be traded. In this case, 10b-5 was not violated.

June 15: Corp learned that its revenues would decrease by 50%, contrary to the announcement on January 2. This is not an action by Director, Officer, or Lawyer. Moreover, Corp probably has no duty to disclose this information so long as it does not trade, and does not make misleading statements about its expected revenues.

June 16: Officer disclosed the probable devaluation to Lawyer.

Tipper-Tippee Liability Under 10b-5

Lawyer is probably a tipper at this point. A tipper is one who discloses corporate inside information, in violation of a fiduciary to the corporation, for personal gain, to one who knows of the officer is violating his or her duty to the corporation by the disclosure. Although Officer has no monetary liability until Lawyer uses the inside information in violation of 10b-5, Officer is probably a tipper at this point, and will become financially liable if Lawyer trades without disclosing the information.

Here, Officer violated his or her fiduciary duty to the corporation by disclosing this information to Lawyer, unless it was necessary to do so in order to obtain the tax advice he sought. If the disclosure was necessary, Lawyer is a constructive insider, and Officer is not a tipper.

The violation, if it occurred, was for personal social gain assuming that informing his lawyer had some social benefit to Officer.

Lawyer probably knew the disclosure by Officer violated a fiduciary duty to the corporation. A lawyer trained in tax law would most likely know this.

Thus, Officer is a tipper and Lawyer is a tippee.

June 17: Lawyer telephone his stockbroker and bought a put option for \$1000.

A. Lawyer's violation of 10b-5

The put option requires OptionCo to purchase 1000 shares from Lawyer at \$20 per share. Since Lawyer believes, based on inside information, the stock will be devalued, Lawyer expects to buy the stock for much less than \$20, and sell it to OptionCo at a profit.

Lawyer has violated 10b-5, and both Lawyer and Officer are liable.

Puts are obviously securities. 10b-5 was violated because Lawyer purchased the put option without disclosing the inside information that the stock would be devalued soon. Lawyer used the telephone, which is an instrumentality of interstate commerce and satisfies the jurisdiction requirement of the rule, the information was material, since Lawyer made use of it immediately.

OptionCo will not be damaged until it buys the stock from Lawyer at \$20 per share. However, the violation of 10b-5 has already happened because 10b-5 prohibits trading in securities while omitting to disclose material inside information. OptionCo needs to be damaged in order to have standing to sue. However, the SEC could sue now.

June 18: The public announcement does not violate any federal securities laws by Director, Officer, or Lawyer.

June 19: Lawyer bought Corp shares at \$5. No violation. Lawyer sold them to OptionCo for \$20,000. Selling these shares gives OptionCo a cause of action against Lawyer and Officer for the \$19,000 damages caused to OptionCo by lawyer and Officer. OptionCo received \$1000

for the put, and will have to pay Lawyer \$20,000 when it buys the stock from Lawyer.

The purchase of stock at \$5 per share was a purchase at the market price at that time. Buying the stock at market price was not a violation of federal securities laws. The violation occurred when Lawyer bought the put.

Moreover, selling the stock to OptionCo at \$20 was not a violation of federal securities laws. The violation occurred with the omission when the put was purchased. However, the damages to OptionCo have just occurred. Now, OptionCo has a cause of action against Lawyer and Officer. OptionCo had not been damaged until this transaction.

July 1: Director bought 1000 Corp shares for \$5 per share.

A. Director's Violation of 16(b)

Director has violated 16(b). This rule prohibits purchases and sales within six months of each other. The order of purchase and sale, or sale and purchase, is not relevant.

Here, Director sold 1000 share at \$25 on March 1, and bought 1000 shares at \$5 per share on July 1. March and July are only 4 months apart. The rule is applicable only against insiders, who for purposes of this rule, are defined as officers, directors, and more than 10% shareholders. Director is a director and therefore an insider.

II ACTIONS WHICH VIOLATED RULES OF PROFESSIONAL RESPONSIBILITY

Lawyer has violated 10b-5 as discussed above. This is a felony. Committing any felony violates the rules of professional responsibility. A lawyer may not engage in conduct involving dishonesty, misrepresentation, or fraud. 10b-5 is an anti-fraud provision of congress.

A lawyer may not use information received from the client to the disadvantage of the client. Here, if lawyer is a constructive insider, the use of inside information violates Lawyer's duty to the corporation, and injures the corporation in the way all inside trading does. It discourages a free market in the stock, and thereby injures the corporation.

Lawyer's conduct may breach the duty of loyalty. The duty of loyalty requires promoting the client's interest, over the interest of others. If Lawyer is merely a tippee, not a constructive insider, Lawyer has nevertheless injured his clients corporation by engaging in insider trading. This is a breach of duty of loyalty to the client.

Word Count: 1067

QUESTION TWO

TITLE: MIKE – OLIVE – BOARD OF ZONING APPEALS
SUBJECT: REAL PROPERTY
FILE: REAL06F.QUE

I. OLIVE V. MIKE FOR WASTE

The doctrine of waste provides that where the present occupier of land substantially reduces the value of the future interest, by conduct which was unreasonable under the circumstances, the holder of the future interest has a cause of action for waste.

Waste usually includes reducing the value of the physical structure by damage, destruction or replacement of the structure. This includes affirmative waste such as actively changing the structure, and permissive waste such as allowing the property to fall into severe disrepair. Waste does not normally include a reduction in the rental or sale value of the property due to loss of intangible benefits such as loss of contract rights, zoning changes, etc. On the other hand, allowing the property to be sold for non payment of taxes is waste.

Here, Mike did not commit affirmative injury to Olive's reversion. However, Mike did fail to renew the easement for parking. This ultimately reduced the value of Olive's reversion because without off-street parking, several offices of the downtown office building had to be left vacant, resulting in a loss of income from the reversion. Loss of the easement for parking is not physical damage to the land, and may not support a cause of action for waste. On the other hand, allowing the land to be sold for non-payment of taxes is not physical harm to the structure, yet this harm is treated as waste.

The court may or may not expand the doctrine of waste to include this type of injury to the reversion. The analogy to the sale of land for non payment of taxes is probably faulty.

A. OLIVE'S SUIT MAY SOUND IN CONTRACT

Olive's suit may be dismissed because the claim may sound in contract rather than as waste. Here, Mike failed to renew the lease for the parking easement. Mike had a contract obligation to do so. Mike breached this contract. Olive now seeks to treat this breach of contract as waste.

The action for waste requires conduct which not only caused injury to the future interest, but conduct which was unreasonable under the circumstances. Can the Olive focus on the unreasonable conduct (failure to renew the parking easement) and sue for a tort, or is the plaintiff limited to breach of contract?

B. WHEN CAN A BREACH OF CONTRACT BE TREATED AS A TORT?

This problem arises frequently with security services. The company contracts to provide security services, yet the house is burglarized. Is this breach of contract or negligence?

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Some courts have treated breach of security services contracts as only a breach of contract, while others have recognized a cause of action for negligence.

Historically, the common law based the dichotomy on malfeasance vs. nonfeasance. Nonfeasance was the failure to perform a promise, and therefore a breach of contract, whereas, malfeasance was an act which created a tort cause of action, usually for negligence.

If the court used this dichotomy, Mike merely failed to perform his contract duty to renew the easement and the cause of action sounds in contract, not tort. In this case, Olive's action for waste should be dismissed, although it could be re-filed as a breach of contract suit.

Modernly, Prosser and others would look to Mike's duty. If his duty arises only from a contract promise, Olive must sue for breach of contract. On the other hand, if Mike owed Olive a duty separate from his contract duty, then Olive can sue in tort for breach of that duty.

Here, Olive will argue that Mike undertook the task of managing the office building, and must do so with due care. Olive will claim the duty to act with due care applies to all conduct, whether the conduct is motivated by contract, or motivated otherwise. Failure to renew the easement for parking was, according to Olive, unreasonable conduct which Mike should have known would result in injury to Olive's reversionary interest.

However, notwithstanding Mike's negligent conduct, Olive's suit for waste should be dismissed. Failure to renew the easement is not waste because Olive's injury is probably not waste.

II. EJECTMENT-LIGHTING-WALL TREATMENT

A. THE ACTION FOR EJECTMENT AGAINST TOBY

The general rule is that one cannot convey rights which he or she does not own. According to the facts, Mike granted a five year lease to Toby. However, Mike's master lease ended a few weeks after the five year lease was granted. Therefore, the latter part of the grant to Toby was void.

Toby may contend that he or she is a bonafide purchaser for value without notice of Olive's reversion. However, if Olive's ownership was recorded, Toby had record notice of Olive's interest. If Olive's ownership was not recorded, Toby had no actual, record, or inquiry notice of Olive's interest, and the five year lease is valid. In this case, Toby cannot be ejected. The lease to Toby was below market price. However, the rule requires that Toby pay value, not market price.

B. MUST TOBY LEAVE THE LIGHTING AND WALL TREATMENTS?

The lighting fixtures which are attached to the building are trade fixtures because they are used

to enhance Toby's art work, and therefore used in his trade. Trade fixtures can be removed by the occupant at the end of the lease, or even shortly thereafter. The tenant must repair the damage caused by the removal.

On the other hand, the wall treatment is an improvement which probably belongs to Olive. The courts look to the objective intent of the annexor. To determine this intent, courts look to the nature of the improvement, the manner of attachment and the amount of damage caused by its removal.

Using objective standards, reasonable people usually intend for the treatment of a wall to become a part of the building. It has no value if removed. Therefore, Toby probably did not intend to remove the treatment. In fact, removing it would probably be spite. However, the restatement position is that a tenant can remove anything, before the lease expires, so long as she restores the premises.

Here, Toby's lease has expired. Toby did not remove the treatments before the end of the lease. The wall treatments remain.

III. BOARD OF ZONING APPEALS

The BZA denied Olive's request for a variance. A use variance is permission to use land in a manner which is inconsistent with the zoning ordinance. The granting of a variance is discretionary. The variance is usually granted where there is unnecessary hardship to the owner which was not caused by the owner, and granting the variance will not be inconsistent with the overall purpose of the ordinance.

It is unclear whether or not Olive meets these requirements. However, it is unimportant. The BZA is a government entity, and must not violate the Equal Protection of the U. S. Constitution. This clause directly applies to the states. Under this clause, those who are similarly situated must be treated equally. There are no exceptions or qualifications to this rule.

Here, according to the facts, BZA recently granted a parking variance for a nearby building under very similar circumstances. BZA must grant the variance.

Additionally, the government may not violate Due Process. Due Process requires that all state action must be a reasonable way to promote health, safety, welfare or morals of its citizens. Here, the BZA denied Olive's request because a nearby parking-lot operator objected. This act is not rationally related to the above-mentioned police power. It violated Due Process. The variance cannot be denied for this reason.

Word Count: 1277

QUESTION THREE

TITLE: LAWYER, DAD, SIS
SUBJECT: PROFESSIONAL RESPONSIBILITY
FILE: PROF04F.ANS

Lawyer has committed several ethical violations:

I. DUTY OF COMPETENCE

This duty requires that Lawyer have the training, skill, and ability to perform the legal services competently. Here, Lawyer evidently is incompetent.

According to the facts, Dad told Lawyer he wanted to create a will leaving everything he owned to his three adult children, Sis, Bob, and Chuck. However, the will and deed which Lawyer has agreed to prepare will not accomplish the clients' announced purpose.

Dad's assets consist of several bank accounts, which he held in joint tenancy with Sis, and his home which he held in his name alone.

When bank accounts are held in joint tenancy, during the lifetime of the parties, the money is owned according to the amounts each party has contributed to the account. Therefore, during the lifetime of Dad and Sis, Dad owned the accounts in their entirety. However, upon his death, the accounts belong entirely to the survivor. This cannot be changed by will.

Thus, upon Dad's death, Sis will own all of the money in the several bank accounts. Bob and Chuck will receive nothing. This is clearly contrary to Dad's expressed wishes that the children share equally in everything he owned.

Additionally, if the deed to his house is put into joint tenancy with Sis, Sis will own the house in its entirety upon Dad's death.

If Lawyer does not understand the above, Lawyer is incompetent. Both ABA Rule 1.1, and CA Rule 3-500 require that Lawyer be competent. Lawyer has breached this duty.

II. DUTY OF CARE

Lawyer is required to exercise due care in providing the legal service to client. Here, Lawyer will produce a result which is dramatically different from what Dad asked for. Lawyer has not even informed Dad that this is so. This is a breach of duty of care.

Lawyer has also created a high likelihood of a wills contest. This is so because there is a presumption of undue influence where:

1. Testator and beneficiary have a confidential relationship, and

2. The will produces unnatural results, and
3. The beneficiary participated in the execution of the will.

Confidential Relationship

A confidential relationship is one in which the testator places a high degree of confidence and trust in a person regarding property. Some jurisdictions presume a confidential relationship between parents and children. Others do not.

Here, Sis and Dad have a confidential relationship. He has all of his property, except his house, in their two names as joint tenants. This was probably intended to allow her to handle his financial affairs, because he is 80 years old, although still competent. It was not intended as a gift to Sis, or Dad would not be at Lawyer's office attempting to devise all his property to his children equally.

Unnatural Results

It is unnatural for a parent with three children to give all the property to only one child.

Participated in the Execution of the Will

Sis participated in the execution of the will. She was present when Dad said he wanted his property to go to the children equally, and said nothing about the consequences of joint tenancy. Of course, the lawyer should have explained this to Dad, but she was present and participating. Additionally, she reminded Dad that he wanted to do something special with the house, and prompted Dad to ask the lawyer to prepare a deed making her a joint tenant of the house. Finally, she paid for the services from her personal bank account.

These three factors in combination create a presumption of undue influence. As a consequence, the sons Bob and Chuck would probably contest this will after Dad's death. This contest would be due to the incompetence, or breach of duty of care, of Lawyer.

III. BREACH OF DUTY OF CONFIDENTIALITY

Lawyer has a duty to maintain the confidences of the client. Here, Dad is competent, and therefore, did not need Sis to explain to Lawyer what he wanted. Lawyer should have dealt with Dad alone, to ascertain his wishes, and prepare documents to accomplish those wishes. Instead, Lawyer violated the confidence by conducting Dad's business in the presence of Sis, and to some extent, under the direction of Sis.

IV. THIRD PARTY PAYER

Lawyer must not permit a third party to pay for Dad's legal services unless:

1. Lawyer obtains informed consent from Dad, in writing, and
2. Lawyer does not disclose information to the third party, and
3. Lawyer does not permit the third party to influence his or her professional judgment.

Here, Lawyer has violated all three parts of this rule. Lawyer did not obtain Dad's informed consent for Sis to pay for these services, in writing. Lawyer disclosed the entire contents of the will to Sis, in violation of part two of the rule. And Sis had a major influence on Lawyer's professional judgment. She ultimately caused Lawyer to prepare documents which did not accomplish Dad's expressed wishes.

V. WHAT SHOULD LAWYER HAVE DONE TO AVOID THESE VIOLATIONS

Lawyer should have exercised reasonable care by informing Dad of the consequences of this acts. In particular, Lawyer should have informed Dad that what he was doing would result in Sis receiving all of his property, and create the potential for a wills contest by Bob and Chuck.

Lawyer should have maintained Dad's confidences. Dad's instructions as to his wishes should have been obtained in confidence, without Sis being present.

Lawyer should not have allowed Sis to pay for the legal services without complying with the rule cited above.

Word Count: 897