

KERN COUNTY COLLEGE OF LAW

BUSINESS ORGANIZATIONS

FINAL EXAMINATION

Spring 2021

Prof. J. Harvey

INSTRUCTIONS: There are three (3) questions in this examination. You will be given three (4) hours to complete the examination.

Question 1

Gillco and Gamestonk are corporations. Gamestonk's shares are traded on the New York Stock Exchange, with 1 million shares currently issued and outstanding.

On December 1, 2020, Gillco bought 150,000 shares of Gamestonk for \$5 per share. Gillco had never previously owned any of Gamestonk's shares. Gillco immediately notified Gerald Rivera, Gamestonk's CFO, of the purchase and indicated it was considering a tender offer at \$9 per share.

The next day, Rivera was meeting with his personal attorney about his estate plan. During the course of the discussion, Rivera mentioned that he expected his personal investments in Gamestonk to significantly increase in value once the tender offer was announced. Although Rivera's attorney congratulated Rivera on the good news, they did not further discuss the proposed tender offer before concluding the meeting.

Unfortunately, Rivera accidentally pocket dialed his sister's boyfriend, Dan DeLyon, on his cell phone about halfway through the meeting. DeLyon hung up the phone upon realizing that the call was not intentional, but not before overhearing the discussion between Rivera and his attorney regarding the anticipated tender offer. Not wanting to embarrass Rivera, DeLyon never mentions the phone call or the information he overheard to anyone.

The following day, Rivera purchased an additional 10,000 shares of Gamestonk for \$5 per share, thereby increasing his total holdings of Gamestonk to 35,000 shares. At about the same time, DeLyon independently decides to purchase 5,000 shares of Gamestonk—also for \$5 per share.

A week later, Gillco announced a tender offer to all shareholders of Gamestonk to purchase up to 70% of the outstanding shares of Gamestonk at a price of \$9 per share, issuing a press release that indicates: "We just like the stock." Assume that all necessary regulatory filings were appropriately submitted.

The following day, Rivera and DeLyon each sold off all Gamestonk shares they owned at a price of \$8.50 per share. The tender offer ultimately failed due to insufficient subscriptions, and Gilco sold off all of its Gamestonk shares at a price of \$6 per share on March 1, 2021.

- 1. Does Gilco have any potential liability under Rule 10b-5? Why or why not?**
- 2. Does Rivera have any potential liability under Rule 10b-5? Why or why not?**
- 3. Does DeLyon have any potential liability under Rule 10b-5? Why or why not?**
- 4. Does Gilco have any potential liability under Rule 16b? Why or why not?**
- 5. Does Rivera have any potential liability under Rule 16b? Why or why not?**
- 6. Does DeLyon have any potential liability under Rule 16b? Why or why not?**

Question 2

Starrvey Nutrition, a corporation founded and owned by Prof. Harvey and Prof. Starr, is the world's largest manufacturer of nutritional supplements designed specifically for sumo wrestlers. The company was founded 15 years ago and uses an original secret formula closely guarded by the company.

Despite sustained early success, Prof. Harvey and Prof. Starr are very concerned with maintaining their position as an industry leader in sumo-specific nutrition. To ensure their product is top of the line, they retain Edwin Honda as a consultant and direct Honda to spend six months traveling to sumo wrestling tournaments around the world in order to conduct field research on the nutritional practices of as many different wrestlers as possible and correlate that information with tournament results. Harvey and Starr specifically authorize Honda to purchase samples of any nutritional supplements that might provide for useful research, subject to the following limitations: (i) Honda may not purchase any supplement that uses identical ingredients to existing Starrvey supplements; and (ii) Honda must obtain specific approval from either Prof. Harvey or Prof. Starr for any purchase that will exceed \$5,000 in a single transaction. To ensure that Honda can avoid purchasing supplements that are too similar to existing Starrvey supplements, Honda is given access to the manufacturing formula and agrees to keep the information confidential.

The following day, Starrvey Nutrition issued a press release that stated: "Starrvey Nutrition is proud to announce that Edwin Honda, a nutritional industry titan, has agreed to join the company's market research team. For the next six months, Mr. Honda will oversee our efforts to ensure we are always improving our products. Just like the sumo wrestlers we serve, our goal is not just to get on top but to stay there."

Over the next six months, Honda entered the following contracts, purporting each time to act on behalf of Starrvey Nutrition:

1. A contract to purchase supplements from GNC for \$4,000;
2. A contract to purchase supplements from Vitamins-R-Us for \$7,000;
3. A contract to purchase supplements from Sam's Sumo Supplies in exchange for a copy of the Starrvey supplement formula; and
4. A contract to purchase a new piece of manufacturing equipment, for \$5,000, that should allow Starrvey to streamline production and improve profit margins on all existing Starrvey products.

Is Starrvey Nutrition legally bound to any of the four contracts?

If so, which ones?

In each case, why or why not?

1)

1) GILLCO (G) 10B-5 LIABILITY

The general rule is that section 10b-5 creates liability for securities fraud and insider trading.

Here, in order to determine whether or not either exist, the elements of each must be analyzed.

SECTION 10B-5 - SECURITIES FRAUD

Under rule 10b-5, it is unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or the mails, or of any facility of any national securities exchange, in connection with a purchase or sale of security to use any device, scheme, or artifice to defraud, make omissions or misstatement of material fact, or any act practice or course of business that operates or would operate as fraud or deceit. To be held liable, the following element must be met. Fraudulent statement or omission of material fact, in connection with the actual purchase or sale of securities with an intent to deceive, and scienter. For an action of private damages, the P must also prove that they bought or sold the security in question, they did so using an instrumentality of commerce, and that they reasonably relied that resulted in damages caused by the fraud.

Here, G made the statement that he was considering a tender offer of Gamestonk's stock at \$9 dollars, but the offer did not go through because of insufficient subscriptions. Although one could argue that G only made that statement to inflate the price of the stock to his benefit, because the facts do not point to any fraudulent intent, especially given the fact that he sold his stocks at a lower price at \$6 dollars, there is likely not a fraudulent statement, and thus, G has not met the elements.

Thus, G like has no liability under the securities fraud section of 10B-5.

SECTION 10B-5 - INSIDER TRADING

A person also violates rule 10b-5 if they breach a duty of trust and confidence owed to the issuer, shareholder of the issuer, or in the case of misappropriators, another person who is the source of the non public info.

Here, in order to determine what type of liability G may have, it must be analyzed whether he was a insider, misappropriator, tipper, or tippee.

Insider

An insider is anyone who breaches a duty not to use inside info for personal benefit, and they can be held liable under rule 10b-5. Typical securities insider, such as directors, officers, controlling shareholders, and employees of the issuer are deemed to owe a duty of trust and confidence to their corporation which is breached by trading on inside info. Constructive insiders such as the insurers CPAs, attorney, and bankers performing serves, also owe such a duty

Here, Gillco notified Gamestonk's CFO of his purchase and his consideration of a tender offer of their stock. The stocks that were traded on were, gamestonks, and because G is not an officer, director, or controlling shareholder of G Stonks stocks and did not hold a duty that those positions would need to have, they did not breach as an insider. Additionally, because he is not a CPA, attorney, banker of G Stonk, G is neither a constructive insider. Because G was only a purchaser and considered a tender offer for G-Stonk's stock, there was duty of trust or confidence that they breached. is not an insider of the Gamestock not on insider or a constructive insider, so owe no duty.

Thus, G has likely not met the elements of an insider.

Misappropriator

Under the missappropriation doctrine, the government can prosecute a person under rule 10b-5 for trading on market info in a breach of duty of trust and confidence owed to the source of the info. the duty need not be owed to the issuer or shareholders of the issuer. Some circumstances where a such a duty can also rise, for example, when a perso agrees to maitian info in confidence, or when a person communicating the info has a history of confidences and has the expectation that the info will stay confident, or info from a spouse, child, or sibling.

Here, as the analysis above shows, G did not have a duty to the issuer, and thus, because there is no breach, there is no liability as an insider. Further, to have liability as a missappropriator, G would also have had to have breached any duty of trust and concidence to the source of the information, and because he was the source of the info, he cant breach a duty to himself.

Thus, has not likely met the elements of a missappropriator.

Tipper/Tippe

Tipsters can be liable for providing inside info to outsiders if the tip was made for any improper purpose and the outsider then trades on the info. Tippees can be liable for trading on inside info only if the tippee knew the tipster was breaching a duty in providing the tip and if the tipster is indeed found liable as a tipster.

Here, it could be argued that G telling Rivera about the tender offer was a tip to Rivera, but because as the analysis above shows, there was likely not an improper purpose to making that tip, he was just telling the CFO that he may want to do a tender offer.

Thus, G is not likely a tipster or tippee.

Conclusion:

Because G has not met the element for securities fraud or insider trading, he is not likely to have any liability under 10b-5.

2) RIVER (R) 10B-5 LIABILITY

Rule - see supra.

Here, Rivera made statements to his attorney, inadvertently to D. In order to determine whether he has liability for either, the elements of securities fraud and insider trading must be met.

SECTION 10B-5 - SECURITIES FRAUD

Rule - See Supra

Here, the statements made to the attorney were not fraudulent or deceitful, he was given his opinion that the price of G Stock may rise after the announcement of the tender offer. This also applies to the statements that Anthony inadvertently heard. Because the fraudulent statement element is not met, R is likely not liable under securities fraud.

Thus, R is likely has no liability under securities fraud section.

SECTION 10B-5 - INSIDER TRADING

Rule - See Supra

Here, Rivera made statements to his attorney, inadvertently to D. In order to determine whether he has insider trading liability for either, it must be determined whether R is an insider, misappropriator, tipper, or tippee.

Insider

Rule - See Supra

Here, R is the CFO of the issuing corporation, G Stonk, and thus has a duty of trust and confidentiality. R has info that G was considering a tender offer of G Stonks shares that was not publicized, and thus inside information. Because R purchased 10,000 shares of G Stonks stocks, he violated the duty to not trade on insider information.

Thus, R is likely liable as an insider under 10b-d.

Misappropriator

Rule - See Supra

Here, for R to be liable as a misappropriator, R would need to have breached a duty owed to the source of the market information, G and their potential tender offer, and trade on info that was breached. G and R do not have a history of maintaining each other's confidences, such that a reasonable expectation exists that the info would remain secret. Because there was no breach of duty to G, there is no liability under the misappropriation theory.

Thus, R not likely liable as a misappropriator.

Tipper/Tippee

Rule - See Supra

Here, for R to be liable as a tipper, he would have had to give his attorney and D inside info made for an improper purpose, and the receivers of the tip, tippees, would have to trade on that info. An argument can be made that the R told his attorney who was helping him with his estate plan, so he could get a personal benefit from the rise in stock price and factor that in the estate planning process. However, because the attorney only congratulated R and did not discuss further, there was not likely an improper purpose. And the attorney did not purchase shares as well, so R is not likely liable as a tipper to his attorney. Further, because D only heard this inadvertently, there was

no possible way that R could have tipped info to D for an improper purpose, and R is not likely liable as a tipper to D despite the fact that D purchased shares.

R could also be liable as a tippee, if he received info from a tippee and made trades on those tips, and if R knew the tipper was breaching a duty. Because G gave R the info in a typical business convo, and because G is not a tipper as the analysis above shows, R is not liable as a tippee.

Thus, G not likely a tipper or Tippee.

Conclusion:

R is likely liable as an insider, but not as a misappropriator, tipper or tippee.

3) DELEYON (D) 10B-5 LIABILITY

Rule see supra.

Here, D was but dialed, and heard information about G's potential Tender offer of G Stonk's stocks, and how R thought their price would rise. So, in order to be held liable, D must meet the elements of either an securities fraud or inside trading.

SECTION 10B-5 - SECURITIES FRAUD

Rule - See Supra

Here, D made no fraudulent statement, now was there a duty for him to speak, and thus, does not meet the element of fraudulent statement or omission of material fact.

Thus, D has no liability under securities fraud section.

SECTION 10B-5 - INSIDER TRADING

Rule - See Supra

Here, D was but dialed, and heard information about G's potential Tender offer of G Stonk's stocks, and how R thought their price would rise. So, in order to be held liable, D must meet the elements of either an insider, misappropriator, tipper, or tippee.

Insider

Rule - See Supra

Here, D is R's sister's boyfriend, and not an insider or a constructive insider. So, even if he traded on G Stonks inside info, because he was not an insider, this element is not met.

Thus, D likely has no liability as an insider.

Misappropriator

Rule - See Supra

Here, for D to be liable as a misappropriator, D would need to have breached a duty owed to the source of the market information, R, and trade on info that was breached. There may be an argument that because D listened in on a convo that was covered by attorney-client privilege, and thus D owes a duty of confidentiality. However, because the call was inadvertent, and because the duty is on the attorney, not a third party, D owes no duty and did not commit a breach. Further, R's attorney was working on personal matters, not copieration matters. Although they may be potential in laws, the facts suggest that R and D do not have a history of maintaining each other's confidences, such that a reasonable expectation exists that the info would remain secret. Because there was no breach of duty to R, there is no liability under the misappropriation theory. The fact that the call was inadvertent, and R did not even know of the call. I

Thus, D not likely liable as a misappropriator.

Tipper/Tippee

Rule - See Supra

Here, for D to be liable as a tipper, he would have had to give a tipper inside info made for an improper purpose, and the receivers of the tip, tippees, would have to trade on that info. D could also be liable as a tippee, if he received info from a tipper and made trades on those tips, and if D knew the tipper was breaching a duty. The facts state that D did not mention the inadvertent call to anyone, and thus, D did not make any tips. D did get inside info from R. However, it is not likely that D knew that R was breaching a duty. Further, because R is not liable as a tipper, D cannot be liable as a tippee.

Thus, D not likely a tipper or Tippee.

Conclusion:

Thus, D is not likely liable under inside trading.

4) GILLCO (G) 16B LIABILITY

SECTION 16B- SHORT SWING TRADING

Section 16b prohibits a director, officer, or shareholder owning more than the percent of outstanding shares of a publicly traded corporation on a national stock exchange or over ten million in assets and 500 shareholders from selling/purchasing or purchasing/selling within six months.

Here, G bought and sold shares of GSTONK, and in order to be found liable, the following elements must be met.

Jurisdiction

Must be listed on national stock exchange or have 10 million in assets and 500 shareholders.

Here, GSTONK is traded on the NYSE, which is a national stock exchange.

Thus, jurisdictional element is met.

Insider

Officers, directors, or shareholders owning more than 10% are liable under 16b. The transaction must be after a shareholder has gotten past the 10% threshold. The transactions that got the shareholder to 10% do not apply.

Here, G is not an insider nor an officer, but he is a shareholder. G is liable if he bought or sold shares after he owned more than 10% of outstanding stocks. Because GSTONK has 1 million stocks, any stock transaction after GSTONK crossed the 100,000 stock threshold are subject to 16b. Because G's first purchase of stock was 150,000 shares of GSTONK, that particular transaction is not held under 16b, only transactions after.

Thus, G is not likely an insider.

Short-Swing Profit

Includes profits and losses avoided, determined by matching the highest sales price to the lowest purchase price within six months.

Here, G made a profit because they bought at 5 dollars and sold at 6 dollars, total profit of \$150K

Thus, this element likely met.

Purchase

Applies to purchases or sales of equity security, which includes stocks.

Here, G purchased GSTONK on December 1, but because that transaction got him to 15% threshold, only transaction after that apply. An the only other transaction after the december 1, 2020, was the March 1, 2021, where they shold of all there shares.

Thus, no purchase or sale within 6 months.

Conclusion:

G not liable under 16b.

5) RIVER (R) 16B LABILITY

SECTION 16B- SHORT SWING TRADING

General Rule see supra

Here, R bought stocks on approximately December 3, after the convo with the attorney,. In order to determine liability, the following elements must be met.

Jurisdiction

Rule See supra.

JDK met, see supra.

Insider

An insider could be an officer, director, or 10 + shareholder.

Here, R is a CFO, and thus an insider of GSTONK, so R's transactions apply under 16B.

Thus, R has likely met these element

Short-Swing Profit

Rule see supra

Here, R bought 10K shares on December 3, at \$5 for total price of \$50k. He sold all GMSTONK shares no more than two weeks later at a price of \$8.50, yielding \$80,500. Total profit on the shares bought and sold within 6 months, the 25K shares R already had does not count, is \$30,500

Thus, R has a \$30,500 short swing profit and this element is met.

Purchase

Rule - See supra.

Here, R bought and sold stocks.

Thus, this element is met.

Conclusion:

R is liable for shortswing profits. The corporation may disgorge these profits. If not action brought by corporation, a shareholder may bring a derivative suit.

6) DELEYON (D) 16B LIABILITY

SECTION 16B- SHORT SWING TRADING

General Rule - see supra.

Jurisdiction

Rule - see supra.

Here, D bought GSTONK shares which trades on NYSE, thus met.

Thus, this element met.

Insider

Rule - see supra.

Here, D is neither an insider, or director, and because he owns only 5K out of 1 million, he is neither a 10 % shareholder.

Thus, this element is not met.

Short-Swing Profit

Rule - see supra.

Here, D bought 5k shares at \$5, for \$25K and sold within 6 months for a profit.

Thus, this element met.

Purchase

See supra.

Here, D bought on December 3, and sold gonk stocks on March 1.

Thus, this element is met.

Conclusion:

D not liable under 16b.

END OF EXAM

2)

Question 2

Agency

Agency is a consensual relationship between a principal and an agent.

A principal may be liable to a third party on a contract if an agent of the principal acted on principal's behalf with actual, apparent, or inherent authority in forming the contract with the third-party. The principal is liable for any conduct engaged in by the agent within the scope of the agent's authority. The principal must have contractual capacity; the agent only needs minimal capacity. The principal and agent can agree to the agency relationship (actual authority), or the principal can hold another out as his agent (apparent authority).

Agent's Duties

The agent owes a duty of loyalty and must disclose interests adverse to the principal. The agent also owes a duty of obedience, and they must obey all lawful instructions of the principal. The agent owes a duty of care and must act with reasonable care, and then finally an agent owes duties under a contract, and must comply with any terms of the agency contract.

Actual Authority

Actual authority exists between a principal and an agent when the words and conduct of principal lead Agent to reasonably believe he had authority to act as he did. This is an objective test judged from the point of view of the Agent.

Apparent Authority

Apparent authority exists when statements made by principal to the third party (or statements made by Agent to the third party with principal's approval) would lead a reasonable person in the third party's position to believe that agent acted with principal's approval. This test is viewed from the third party's position.

Inherent Authority

Inherent authority may bind Principal to a contract even if Principal expressly did not approve or forbade the actions of Agent, if: (i) the Agent's act was incidental to a transaction or was within the

scope of ordinary conduct for which Agent did have authority, and (ii) the third-party reasonably believed Agent had authority to act (i.e., the third party was not on notice that agent was forbidden by principal to act as he did).

1. Is Starrvey Nutrition legally bound to the contract to purchase supplements from GNC for \$4,000?

Agency defined supra.

The only issue here is if the supplements contracted for with GNC are identical to the Starrvey ingredients as Honda was specifically instructed to not purchase any supplements with identical ingredients. Depending on whether Honda truly knew what he was looking for, Starrvey may be bound to the GNC contract if (a) believing the ingredients were different, Honda acted with actual authority, or (b) GNC likely would not have known that Honda was to avoid contracting for supplements that were identical to the Starrvey supplements, and therefore would have inherent authority.

Agent's Duties defined supra.

Honda owed a duty under the contract to the principals. On its face, it does not appear as though Honda breached any duty. However, if the supplements he purchased from GNC were identical to the supplements used in the Starrvey product, then he would have breached his contract forbidding him from doing that very thing. With the limited facts, it is unclear whether Honda breached his contract with the principals.

Actual Authority defined supra.

Since the contract price is for \$4,000, which is below the \$5,000 limit, Honda acted with actual authority, thereby making Starrvey legally bound to the GNC contract.

Inherent Authority defined supra.

GNC most likely would not have known that Honda was instructed to not purchase supplements with identical ingredients to Starrvey. Regardless, as GNC would likely believe that Honda had inherent authority, Starrvey would be legally bound to the contract with GNC.

In conclusion, whether or not the ingredients were identical is not the issue with this contract. The fact that both Honda and GNC believed that Honda had the authority to enter into the contract is enough to make Starrvey legally bound to this contract.

2. Is Starrvey Nutrition legally bound to the contract to purchase supplements from Vitamins-R-U's for \$7,000?

Agent's Duties defined supra.

Honda breached the duty of obedience by not obeying all of the lawful instructions provided by Harvey and Starr. He entered into a contract to purchase supplements from Vitamins-R-U's for \$7,000, which is \$2,000 over the \$5,000 limit. He was to obtain specific approval from the principals on any expense exceeding \$5,000.

Actual Authority defined supra.

Honda was retained as a consultant and given authority to spend six months to travel to sumo wrestling tournaments around the world in order to conduct field research. Harvey and Starr specifically authorized Honda to purchase samples of any nutritional supplements that might provide for useful research. Honda was an agent that had actual authority to enter into contracts for up to \$5,000. This contract exceeds his limit. Honda did not have actual authority to enter into the contract.

Apparent Authority defined supra.

When Starrvey Nutrition issued the press release that publicly announced Honda agreed to join their research team, Honda was an agent that had apparent authority. Whether the agent has authority or not under this doctrine is determined from the viewpoint of the third party. It would not be far-fetched that due to the glowing press release about Honda that many vendors would deem him as an expert that Starrvey relies on, therefore having apparent authority.

Inherent Authority defined supra.

Even though the facts indicate that Starrvey expressly forbade Honda to enter into contracts that exceeded \$5,000 without their approval, they may still be legally bound to honor the contract. If Vitamins-R-U's reasonably believed that Honda had authority to act (i.e., the third party was not on notice that agent was forbidden by principal to act as he did), then Starrvey would likely be legally bound to honor this contract with Vitamins-R-U's for \$7,000.

Remedies of a Principal defined supra.

A compensated agent can be held liable for damages based on breach of contract. The facts are silent as to what type of compensation was agreed upon between the principals and agent, but if the

principals can prove they have been damaged as a result of the breached contract, then the agent could be held liable.

The question here includes what supplements were being purchased? DO any of those supplements use identical ingredients to the existing Starrvey supplements? If so, in addition to spending beyond the \$5,000 limit, Honda would also have breached his agent contract by not checking that he was not duplicating ingredients. Further investigation would need to be done in order to determine to what extent Honda followed instructions. Was it only by spending in excess of the \$5,000, or is it coupled with not checking the ingredients. Ultimately, it would be up to the principals whether they would want to take action against Honda. If Honda did enter a contract to purchase supplements that were identical to Starrvey Nutrition, then that would be a significant breach. However, if the supplements all had different ingredients from the Starrvey Nutrition ingredients, then the principals would need to decide if they would want to enforce a breach. After all, they were giving Honda six months to travel to locations to purchase supplements, so \$2,000 may not be an exceptionally large breach.

In conclusion, Vitamins-R-Us was probably unaware that Honda was restricted to a \$5,000 contract. This may be partly due to the press release issued by Starrvey, which would have given Honda both apparent authority and inherent authority. It is likely that Starrvey will be legally bound to honor this contract.

3. Is Starrvey Nutrition legally bound to the contract to purchase supplements from Sam's Sumo Supplies in exchange for a copy of the Starrvey supplement formula?

Agent's Duties defined supra.

Honda has fully breached his duties as an agent. Specifically, he has breached his duties of loyalty, obedience, care and his duties under contract.

Actual Authority defined supra.

There is no argument that would defend Honda's belief that he had actual authority to enter into a contract in exchange for a copy of the Starrvey supplement formula. Honda was specifically told what it was and agreed to keep it confidential. Honda did not have actual authority.

Apparent Authority defined supra.

The facts do not provide anything that would lead a reasonable person in the third party's position to believe that Honda acted with Starrvey's approval. Sam's Sumo Supplies was likely a competitor with Starrvey, particularly since Starrvey's nutritional supplements were specifically designed for sumo wrestlers. A reasonable person would not agree or believe that Honda carried any apparent authority.

Inherent Authority defined supra.

Starrvey expressly forbade Honda from divulging their manufacturing formula. Honda in no way acted within the scope of ordinary conduct because he specifically agreed to keep the formula confidential. Finally, Sam's Sumo Supplies argument that they reasonably believed Honda had the authority to act would fail. Sam's would not be required to be put on notice that Honda was not to divulge the formula. Any reasonable person would agree that the formula was confidential, and Honda breached his duty by divulging the formula to a competitor.

Remedies of a Principal defined supra.

By knowingly divulging the confidential manufacturing formula, Honda can be held liable for damages, although the extent of the damages are unknown at this time.

In conclusion, Honda breached his duty as an agent. He had neither actual, apparent, or inherent authority to enter into this contract and divulge the confidential formula. He breached his promise of confidentiality. While Starrvey may choose to take action against Honda, they will not be held legally bound to honor this contract.

4. Is Starrvey Nutrition legally bound to the contract to purchase a new piece of manufacturing equipment for \$5,000 that would allow Starrvey to streamline production and improve profit margins?

Agency defined supra.

Honda was specifically retained as a consultant to "conduct field research on the nutritional practices of as many different wrestlers as possible and correlate that information without tournament results." He was not authorized to purchase a new piece of manufacturing equipment. The facts state that the new piece of equipment would allow Starrvey to streamline production and improve profit margins on all existing Starrvey products. The facts lay out that this is what the piece of equipment will do, but how does Honda know that Starrvey doesn't already own this piece of equipment. Manufacturing equipment was not within Honda's scope of work.

Agent's Duties defined supra.

Again, Honda's scope of work was to research and purchase supplements, not manufacturing equipment. By entering into this unauthorized contract Honda has breached his duty of obedience by not following Starrvey's lawful instructions. Honda has also breached his contract because he did not comply with the specific terms.

Actual Authority defined supra.

According to the facts, the terms were pretty clear as to what Honda was allowed, and not allowed, to do. He could research and purchase supplements, and enter into contracts that did not exceed \$5,000 without prior approval. Starrvey did not give Honda actual authority. Honda may make the argument that since he did not exceed the \$5,000 limit. Additionally, due to the press release touting Honda's abilities to oversee their efforts to ensure they are always improving their products, Honda may have believed that he was given authority, and as long as he did not exceed the \$5,000 limit, he was free to enter into a contract to help them improve their products.

Apparent Authority defined supra.

Apparent authority is viewed from the perspective of the third party and is measured by what a reasonable person in the third party's position would believe. This could be an argument in defense of Honda. The press release announced that Honda had agreed to join the company's market research team and that Honda would oversee their efforts to "ensure [they] are always improving [their] products. The press release was not specific as to Honda's retainment to research supplements. A reasonable person may believe that "improving" products could also include improving the packaging and the manufacturing in addition to improving the actual product.

Inherent Authority defined supra.

Starrvey did not expressly approve, or forbid, Honda from entering into a contract for manufacturing equipment. It was not a transaction within the scope of ordinary contact for Honda, but again, a third-party could have reasonably believed that Honda had the authority to enter into this type of contract.

In conclusion, whether or not the ingredients were identical is not the issue with this contract. The fact that both Honda and GNC believed that Honda had the authority to enter into the contract is enough to make Starrvey legally bound to this contract.

Indemnification

Even if a principal is found to be liable to the third-party through the inherent authority of the agent, the principal could still recovery from the agent.

Since Honda expressly did not act within the scope of the authority given to him by Starrvey, Honda could be liable to Starrvey for any resulting damages. He may be required to indemnify Starrvey for any reasonable costs and expenses incurred by liability resulting from Honda's actions. Starrvey may, therefore, be entitled to recover expenses such as attorney's fees from Honda for having to defend a case initiated by a Third Party.

In conclusion, Honda appeared to of breached his agent's duties of obedience and to the contract, He was not given actual authority to purchase manufacturing equipment. Due to the press release, however, Honda, as well as any reasonable third-party, may have believed that Honda had actual, apparent and/or inherent authority to enter into the contract. Depending on whether the reasonable third party believed Honda to have apparent or inherent authority would determine whether Starrvey would be legally bound to honor this contract for manufacturing equipment.

END OF EXAM