

SECURITIES REGULATION

Professor John Orcutt

Fall Semester 2006

FINAL EXAMINATION**Instructions:**

1. This is an open-book examination. You may bring any materials you wish to the examination with the exception of computers, telephones or other electronic devices. Calculators, however, are permitted.
2. This is a 3-hour examination.
3. This examination consists of 5 essay questions and is worth 180 points.
 - ▶ Question 1 will be worth 35 points
 - ▶ Question 2 will be worth 40 points
 - ▶ Question 3 will be worth 15 points
 - ▶ Question 4 will be worth 50 points
 - ▶ Question 5 will be worth 40 points

It is your responsibility to apportion your time appropriately amongst the 5 questions. If you base your time on the number of possible points per question, the time apportionment should be:

- ▶ Question 1 = 35 minutes
 - ▶ Question 2 = 40 minutes
 - ▶ Question 3 = 15 minutes
 - ▶ Question 4 = 50 minutes
 - ▶ Question 5 = 40 minutes
4. The grading of examinations is anonymous. So, you must write your examination number on the examination and each blue book that you use. **YOU MAY NOT WRITE YOUR NAME ON ANYTHING – YOU MAY ONLY USE YOUR EXAM NUMBER.**
 5. Please write your answers in blue books. Remember to write your examination number on each blue book that you use. The only answers that will be graded are the answers written into a blue book. While you are free to use scratch paper, answers written on scratch paper, or anything else other than a blue book, will not be read and will not be counted for any credit. Please write only on the front side of the pages in the blue book. Please remember that organization, persuasiveness, neatness and legibility all count in determining your grade on an answer. To improve the organization of an answer, you may wish to quickly outline the answer on a separate sheet of paper prior to writing your full answer in the blue book.
 6. Should you find it necessary in answering a question to assume a fact not given in the problem as stated, you may do so. However, you should clearly indicate that you are making an assumption and you should explain why you consider it a reasonable assumption to make.
 7. I have tried my best to write and proofread the exam so that there are no distracting typos or other errors – but, I may not have been totally successful. If you believe there is a typo or other error that makes it difficult to answer a particular question, please point out the error in your blue book and any assumption you used to answer the question.

Good luck on the examination!

DO NOT TURN TO PAGE 2 UNTIL THE PROCTOR TELLS YOU TO BEGIN

BACKGROUND INFORMATION FOR QUESTIONS 1 – 3:

WebVan Group, Inc. (“WebVan”) is an Internet retailer of “grocery store” products (primarily food, non-prescription drug products and general merchandise). Through its innovative business design, WebVan (a) allows customers to perform their grocery store shopping over the Internet and (b) provides same-day home delivery of those purchases. WebVan is an extremely “hot” company. WebVan is by far the largest Internet grocery store. Industry experts estimate that WebVan has roughly 40% market share for the Internet grocery store market.

Key WebVan officers are:

- Betty Crocker = Chief Executive Officer (“CEO”) of WebVan
- Chef Boyardee = Chief Financial Officer (“CFO”) of WebVan

During late August 2006, WebVan decided to conduct an initial public offering (“IPO”). WebVan selected Quatrone Securities (“QS”), one of the leading investment banks on Wall Street, to act as its lead underwriter for the IPO. WebVan was a private company at that time and remained a private company until its registration statement went effective.

The organizational meeting¹ for the IPO was held in mid-September, at which time QS proposed the following basic schedule for the IPO:

- September 22 – November 30, 2006: Conduct due diligence and draft the registration statement
- December 1, 2006: File the registration statement with the SEC
- January 12 – 30, 2007: Road show
- February 2, 2007: Go effective and price the deal
- February 5, 2007: Closing

Please answer the following three questions relating to the WebVan IPO. In each case you should assume that you are outside counsel representing WebVan.

¹ The purpose of the organizational meeting is (a) to go over the scheduling for the IPO, (b) to discuss any material issues that could impact the offering or its timing and (c) to assign the tasks and responsibilities to the various parties for the IPO. *Description and Flow Chart for a Hypothetical Initial Public Offering.*

QUESTION NO. 1 (35 points possible – 35 minutes): For purposes of Question No. 1 only, please assume the following additional facts.

In March 2006, Betty Crocker (WebVan's CEO) was invited to make a presentation at an industry conference. Specifically, she was invited to make a keynote presentation at GroceryExpo, which is arguably the largest grocery store industry trade show in the world. GroceryExpo is held in mid-November of each year and is a virtual must attend for grocery stores and grocery store suppliers, as the event provides attendees and participants the opportunity:

- To give and to hear speeches on current happenings that are shaping (and future trends that will shape) the industry;
- To learn about (and to expose other to) new products and technologies; and
- To meet suppliers and to negotiate important supply contracts.

For the presentation, she was asked to give a talk on the future of Internet-based grocery shopping, including her projections on the size and growth trajectory of the market for the next five years. The presentation would be a live speech and would not include Power Point (Betty hates Power Point). Betty would, however, like to provide audience members with a written report that she has prepared that (a) outlines her argument for the growth of the Internet-based grocery shopping market and (b) includes her market projections. Betty believes the speech would be very valuable for WebVan, as it would allow her to publicly explain to suppliers how important WebVan would be in the near future, which she believes would improve WebVan's ability to negotiate more favorable supply agreements. Because of the benefits to WebVan, Betty immediately accepted the invitation back in March 2006 (long before WebVan decided to conduct the IPO).

One more thing on GroceryExpo – because of its immense importance to the grocery store industry, it is well covered by the financial press. If Betty gives her presentation, we should assume that the financial press will take her speech and turn it into articles with forecasts on the size of the Internet-based grocery market.

Betty is scheduled to give this presentation on November 15, 2006. Can Betty give the presentation? Please analyze the situation for WebVan.

QUESTION NO. 2 (40 points possible – 40 minutes): For purposes of Question No. 2 only, please assume the following additional facts.

WebVan filed its registration statement during December 2006. During January 2007, Betty and Chef Boyardee (WebVan's CEO and CFO, respectively) will conduct the "roadshow", where they intend:

- To make presentations to groups of potential investors. These presentations will include both live speeches and PowerPoint presentations;
- To provide the potential investors with copies of WebVan's preliminary prospectus; and
- To undertake individual meetings with potential investors and attempt to determine their interest in purchasing WebVan shares in the IPO (how many and at what price).

Please analyze whether each of WebVan's intended activities will be in compliance with § 5 of the Securities Act.

QUESTION NO. 3 (15 points possible – 15 minutes): For purposes of Question No. 3 only, please assume the following additional facts.

WebVan included the following legend on the cover page of its S-1 Registration Statement and each amendment thereto:

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to such Section 8(a), may determine.

Please explain why WebVan included that legend on the cover page of its S-1 Registration Statement and each amendment thereto.

*** * * * * END OF WEBVAN QUESTIONS * * * * ***

QUESTION NO. 4 (50 points possible – 50 minutes):

ABC Company ("ABC") is an international contractor serving the oil and gas industry. Specifically, ABC specializes in the design, fabrication and installation of offshore oil and gas platforms that are used by oil companies for offshore drilling. In 1995, ABC conducted an initial public offering ("IPO") of its common stock and listed the stock on the New York Stock Exchange ("NYSE"). ABC has remained a reporting company since its IPO.

ABC plans on issuing a press release (the "Press Release") that will include ABC's revenue projections for the next few years. The current draft of the Press Release contains the following text related to the revenue projections:

"ABC is forecasting a 10 – 15% growth in revenues for the next few years."

The draft of the Press Release also includes as its final paragraph the following statement:

"We have included in the press release certain 'forward-looking statements,' as that term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent only our current beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside of our control. These statements can be identified by terminology such as "may", "will", "expects", "anticipates", "believes", "estimates" and "forecasts" or other comparable terminology. ABC's actual results may differ materially from those projected in these statements. ABC is under no obligation to update any forward-looking statements after the date of this release."

ABC plans on filing the Press Release with the SEC pursuant to a Form 8-K. You are an associate with ABC's outside law firm and have been asked to assist in preparing and filing the Press Release under Form 8-K. Following a conversation with ABC's CFO, you realize that the Press Release does not mention that the projected revenue growth is predominantly in a very low-margin part of ABC's business. While ABC believes that it will generate comfortable revenue growth over the next few years, ABC is not expecting significant profit growth (ABC's internal projections are for profit growth of 0 – 2%). None of Form 8-K, Regulation S-K or Regulation S-X has a specific requirement that an issuer must disclose revenue or profit projections.

The partner for whom you work has asked you to look into the situation. In doing so, the partner made the following statement to you:

"As a reporting company, ABC is required to disclose all material information about itself. It looks to me that ABC will be committing a 'material omission' if it does not include the profit projections."

Please answer the following questions:

- (a) (i) Is the partner correct in saying that a reporting company is required to disclose all material information about itself? **Please explain.** (ii) ABC wants to know if federal securities law requires it to include the profit projections in the Press Release. **Please analyze.**

- (b) For purposes of Question 4(b) only, please assume the following additional facts. The Press Release was issued. Roughly six months after the Press Release was issued, ABC realizes that its revenue projections were too aggressive. Rather than a 10 – 15% growth in revenues, ABC now believes that revenue growth will be closer to 3 – 5%. Does ABC have a duty to update its prior 10 – 15% growth projections?

QUESTION NO. 5 (40 points possible – 40 minutes):

The following events took place between December 5th and 6th.

Jane Smith was the president and controlling shareholder of Acme, Inc. ("Acme"), a publicly-traded supermarket chain. Acme was in heavy negotiations to sell itself to Big Co. ("Big") at a 75% premium to Acme's then-current share price. Acme was trading at roughly \$50/share at the time.

During the morning of December 5th, Big and Acme agreed that Big would acquire Acme at a purchase price of \$87.50/share. Big and Acme planned to publicly announce the deal before the open of the market on December 6th. Not surprisingly, Jane was ecstatic after the deal was agreed to. This was the high point in her already very impressive career. Unable to contain her joy, Jane called her husband, Fred, and shared the good news with him. Jane started the conversation by cautioning Fred that the information was strictly confidential and that he was not to disclose it to anyone.

Later that day, Peyton (Fred's boss) came into Fred's office. Fred told Peyton all about his conversation with Jane. It is not entirely clear why Fred did that. One possible reason may have been that Fred wanted to warn Peyton that Fred would be less available for work for the next few months because Jane would be so busy. It should also be noted that Fred was in line for a big promotion at that time. Irrespective of Fred's motivation, Peyton returned to his office after the conversation and proceeded to call his broker and buy \$200,000 worth of Acme stock.

On December 6th, the Acme/Big deal was announced as scheduled. Peyton quickly sold his Acme shares that day and realized a profit of roughly \$135,000.

The above information came to the attention of the SEC earlier today. Please outline the SEC's case for insider trading under Rule 10b-5 against both Fred and Peyton.

END OF EXAM

I wish you all a happy and well-deserved break!