

**University of Arkansas, Fayetteville**

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# Use of Simulations and Client-Based Exercises in the Basic Course

Carol Goforth



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# USE OF SIMULATIONS AND CLIENT-BASED EXERCISES IN THE BASIC COURSE

*Carol R. Goforth\**

I began teaching full time more than a decade ago, and initially I modeled my classes after most of those that I had taken in law school. After the humbling experience of reading student evaluations, I quickly discovered that some of the tried-and-true methods of teaching were not giving my students what they wanted. As a recent convert from private practice, I was particularly sympathetic to the suggestions of students that class would be much more interesting if I gave them a better idea of the real world business issues we were studying in theoretical terms. This was the impetus for me to include simulation exercises in the introductory Business Associations class.

Over the last ten years, there have been a number of changes in the way I have taught the basic course. I began my law teaching career at an urban school in the Northeast, where a significant number of graduates could expect to (and often did) join large law firms with a number of public companies as clients. At that school, the basic course was a four-hour class designed to introduce all types of business associations, including publicly held entities. Even at that time, which was before the widespread acceptance of limited liability companies (LLCs) and limited liability partnerships (LLPs), we were hard pressed to cover the basic issues relating to agency, partnerships, and corporations. Due to the enormous amount of material, the choice to devote class time to simulation exercises was difficult to make. Nonetheless, I did attempt to involve the students in simulated client interviewing sessions and drafting sessions based on those mock interviews.

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\* Arkansas Bar Foundation Professor of Law, University of Arkansas School of Law. The author would like to thank Professor Judith Kilpatrick for her willingness to share perspectives on the teaching of practical skills to law students; Professors Frank Bozzo and Tim Tarvin, for their willingness to play the clients in some of these exercises; Marshall Prettyman, Esq., for the same; and the many students who eagerly (and sometimes not so eagerly) participated in my teaching experiments.

When I relocated to a different law school, I found that at my new academic home there were two basic courses: a three-hour class devoted to agency and partnership issues (and LLCs once those were widely recognized), and a three-hour class introducing corporate issues. With more time to spend on these general topics, it was possible to expand the types of simulation exercises that I used.

For a variety of reasons, however, the faculty at my current institution recently decided to repackage our basic course, so that we now offer an introductory Business Organizations class covering all closely held business forms. Agency issues, partnerships, LLCs and closely held corporations are all discussed in this one class in varying degrees of specificity.<sup>1</sup> Even though we have allocated four credit hours to this class, time is once again at a premium. Nonetheless, I am convinced that simulation exercises are a valuable addition to the teaching techniques that I employ, and I intend to continue to devote some of my class time to this type of exercise. The remainder of this Essay is devoted to two topics: (1) describing why I believe that these client-based simulation exercises are so valuable; and (2) providing a more detailed description of some of the exercises that I employ.

## I. THE VALUE OF CLIENT-BASED SIMULATION EXERCISES

My initial justification for client-based simulations continues to be that students enjoy and learn from them. My students tend to be more involved and more animated during or following these exercises. Even more importantly, they tend to remember the issues presented in this manner better for the final exam. For example, if I use a dispute about the valuation of a business as the basis for a negotiation exercise, students appear to have a better recall and understanding of basic principles of valuation on the exam. Similarly, if I conduct an in-class drafting session dealing with how a particular form of business is organized, students are better able

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<sup>1</sup> Issues relating to publicly held corporations are deferred to a three-hour Advanced Corporations class.

to spot errors in those procedures on the exam than if we merely talk about the statutory requirements in class.

Another reason I like client-based simulations is that they provide an opportunity to review the substantive law that we study in class, in a context that quickly reveals any flaws in understanding. The process of conducting a mock interview or counseling session, or participating in a simulated negotiation, forces the students to use the rules rather than merely reciting them. The process also requires students to integrate the different materials we are considering since my problems tend to have multiple issues.

I find that simulated exercises also offer an excellent opportunity to integrate ethical issues applicable to representation of business clients into the basic course. Students are thus required to deal with substantive business law in the context of a lawyer's ethical responsibilities, which I believe cannot be overemphasized.

Finally, simulation-based exercises provide students with an opportunity to practice or observe skills that are essential to the practice of law. Since the schools with which I have been associated have taught have tended to under-emphasize transactional practice and skills, incorporating simulation-based exercises into my class is a very important consideration for me.<sup>2</sup> It was the transactional side of law practice that I most enjoyed, and I often felt inadequately prepared for many of the roles in which I found myself. This deficiency in legal education should not be perpetuated. Transactional simulations fit well into a Business Organizations or Corporations class, and most students need the exposure because they will not get it elsewhere while they are students.

Thus, my goals for a program of client-based simulations in the introductory class are:

- (1) to present the substantive rules of law being covered in the basic course in a way that makes them "real" to the students,

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<sup>2</sup> My experience suggests that the case method emphasizes the litigation side of legal practice, and this emphasis appears even in subjects like Contracts, where a transactional focus would at least be theoretically possible. Even in skills courses like Negotiation, most exercises I have seen tend to be in the dispute-settlement context.

thereby enhancing understanding and recall;

- (2) to force the students to deal with multiple issues at the same time;
- (3) to allow students to practice and/or observe skills that are essential in the practice of law;
- (4) to emphasize the rules of professional conduct that apply to the representation of clients in a business context; and
- (5) to offer students some exposure to transactional practice.

## II. SIMULATIONS EXERCISES

With these goals in mind, I have created a series of client-based exercises. Because I teach my basic class to relatively large enrollments,<sup>3</sup> most of the exercises are actually conducted in front of the class by a smaller group of students. The rest of the class is allowed to comment and ask questions after the exercise is completed. Some exercises require the participation of the entire class.

### A. THE INITIAL CLIENT INTERVIEW

Very early in the semester, I stage a mock interview in which students conduct an initial interview with a prospective client. I select three students to conduct the interview, provide them with additional reading material about interviewing techniques,<sup>4</sup> and have them interview the new "client" in front of the class.<sup>5</sup> The

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<sup>3</sup> The size of my basic Corporations or Business Organizations class typically ranges between sixty and ninety students. I have taught as many as 105 students in a single class, but hope to avoid repeating that experience.

<sup>4</sup> I suggest selected parts of Chapter II in LEONARD RISKIN & JAMES WESTBROOK, *DISPUTE RESOLUTION AND LAWYERS* (1987), and Chapter 7, entitled "Beginning Client Conferences," from DAVID A. BINDER ET AL., *LAWYERS AS COUNSELORS: A CLIENT-CENTERED APPROACH* (1991).

<sup>5</sup> In order to increase the volume at which the interview is conducted I seat the "client" on one side of the classroom and the three "associates" as far away from him as possible and still have them all at the front of the room.

memo to the three students places them in the role of junior associates, and asks them to find out what the client wants. They are told only that the firm's conflicts check has cleared the incoming client.<sup>6</sup> The client is also given specific information about his role, and some general instructions on how to act during the interview.<sup>7</sup>

When we conduct this interview, the class has completed an overview of available forms of business organization. We have covered only the basic characteristics of the sole proprietorship, general partnership, limited partnership, limited liability partnership, limited liability limited partnership, limited liability company, and corporation. Thus, I do not expect great things from the student interviewers in terms of substantive knowledge. Rather, this exercise is designed: (1) to demonstrate the wide variety of issues relevant to a decision to begin a new business; (2) to provide a review of some basic characteristics of some business forms;<sup>8</sup> and (3) to introduce ethical considerations, such as the requirement of competence in a representation, the issue of who is the client, and issues relevant to the joint representation of multiple clients.

The interview takes about an hour of class time, and I usually take fifteen minutes or so for a follow-up discussion. I typically ask the students who observed the interview what they would have done differently, and usually one or more of them will point out any erroneous statements about the law made during the interview. I generally lead the discussion on the ethical issues, as a fair number of my students will not yet have studied professional responsibility.

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<sup>6</sup> The entire text of the memo to the students (as junior associates) reads as follows:

You have been assigned an initial interview with Joe Cool, Jr., a new client, to be held [at your regular class time in the class room]. Mr. Cool has retained the firm to assist with the formation of a new business. While we generally do only litigation work, his father's company is a major client, and we need to undertake this project. We have no conflict with representing the son. Please find out enough information so we can begin this project as expeditiously as possible.

<sup>7</sup> A copy of the instructions I gave to my "client" in 1999 are included here as Appendix A.

<sup>8</sup> Student interviewers inevitably offer advice and make statements about the law despite their ignorance of it. Often, the most memorable portions of this class involve a discussion of whatever the interviewers got wrong in the interview.

## B. THE FOLLOW-UP DRAFTING PROBLEM

As a follow up to the interview, I conduct an in-class drafting exercise. The first major unit in my course is the formation stage of business organization, and when we finish looking at the chapter covering statutory requirements, I have the class help me modify a sample form to suit the client's needs. I review with the class the information that we should know from the initial interview, and I tell them that the client has chosen the corporate form for his business.<sup>9</sup> Next, I present transparencies of an old form that I supposedly found in the senior partner's files.<sup>10</sup> Each student is given a copy of the form, and I stand at the front of the class and take suggestions about how to correct the form.

The process is instructive for a number of reasons. First, it forces the students to work through the statutes, which they are almost always reluctant to do.<sup>11</sup> Second, it illustrates some of the most common problems with the use of forms: (1) they may be out of date and inadequate under the current law; (2) they may contain provisions that invite problems if the student or lawyer does not fully understand them; and (3) they may not fit the current client's needs or preferences.

The sample form that I use is intentionally out of date, but the only indication of this fact is a reference to the "Corporations Act of 1947."<sup>12</sup> The use of this out-of-date form obviously presents problems.

First, the document includes archaic, redundant phrases, such as "henceforth," "shall be and hereby is," and "expressly understood, agreed and acknowledged." Second, the form includes requirements

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<sup>9</sup> I could just as easily use the LLC or any other business form.

<sup>10</sup> A copy of this "old form" appears in Appendix B. I hand this form out the day before we conduct the in-class drafting project and tell students to correct the form before they come to the next class. If our classrooms were properly wired, I might be able to do my drafting on a computer with the results projected for the students. If your school is more technologically up-to-date, there are many ways in which this type of in-class drafting might be accomplished.

<sup>11</sup> I use the Arkansas statutes for this purpose because the Arkansas Secretary of State has some quirks that I like to discuss with my class, but any state statute or model act would work.

<sup>12</sup> An attentive student in my class will be aware that Arkansas adopted a version of the Revised Model Business Corporations Act in 1987 and should be aware that the newer statute will control in the case of a newly organized corporation.

from the earlier statute that are no longer necessary (i.e., the names of the initial directors, the need to disclaim preemptive rights, the need to have three incorporators, and the need to represent that at least five hundred dollars in subscriptions has been received). Third, the outdated form contains provisions that no longer satisfy the statutory requirements (i.e., listing the principal business office rather than the registered office). Finally, the document includes language that under contemporary legal conditions is likely to cause unanticipated negative consequences (chiefly, its reference to no-par stock, which could result in the imposition of significantly higher franchise taxes than necessary under Arkansas law).

As we revise the document in class, I urge students to be methodical in their approach. My students tend to want to start with the old form, and it usually takes some doing to convince them of the wisdom of starting with the statute. I am, however, in a position to insist. We then discuss (in varying degrees of detail) each of the statutory requirements, and as we go through the statute we revise the corresponding language in the form.

It is not too hard to convince students to abandon the old-fashioned legalistic phrasing—a goal also emphasized in our Legal Research and Writing courses. The students are also able to see why we have to do what a new statute says if it is in complete disagreement with the earlier provisions. I get more arguments when it comes to convincing them that there are extraneous provisions that can be and probably should be jettisoned because the law has rendered them unnecessary. A surprising number of students over the years have suggested that if the form was good enough for the senior partner, it should be good enough for them. My suggestions that most clients would rather have a shorter document filed as a matter of public record, and that they would rather preserve the maximum degree of flexibility, do not always bring students around to my point of view on this issue.

Usually, the most difficult lesson comes from consideration of the no-par value provision, which is included in the senior partner's form. The modern Arkansas corporate statute requires the articles to specify the par value of shares, or the fact that shares are without



par value.<sup>13</sup> Very few students will have made any attempt to figure out what this means before I raise the question in class, and I have *never* had a student figure out that the franchise tax statute (which is in an entirely different title in our state code) sets the franchise tax based on the par value of the outstanding shares and that no-par stock is presumed to have a par value of twenty-five dollars per share for this purpose.<sup>14</sup> Thus, the use of no-par stock can quickly result in significant franchise taxes being assessed beyond what a start-up corporation should have to pay.<sup>15</sup>

After this discussion, students often seem on the verge of being angry, as if I have played some unfair trick since I do not give them the franchise tax statute or talk about it in class before assigning this project.<sup>16</sup> In reality, I am trying to bring home to them the importance of doing their homework. Before a provision is included in a document a lawyer is preparing, the lawyer should be certain of that provision's consequences.<sup>17</sup>

Finally, after we have revised the form, I ask students to come back the next day and tell me exactly what they would have to do to get the Secretary of State to accept the document for filing. By the next class, most students are quick to tell me about requirement that the document be filed in duplicate and that there is a fifty dollar filing fee. Both of these requirements appear in the corporate

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<sup>13</sup> ARK. CODE ANN. § 4-27-202.A.2 (Michie 1997).

<sup>14</sup> The corporate franchise tax provision is codified at ARK. CODE ANN. § 26-54-104(a)(6). This provision imposes a franchise tax calculated on the basis of .27% of the par value of the corporation's outstanding capital stock, with a minimum of \$50 per annum and a maximum \$1,075,000. A subsequent provision specifies that "shares of no par value shall be considered to be of the par value of twenty-five dollars (\$25.00) per share." *Id.* § 26-54-105(e)(2).

<sup>15</sup> If the corporation authorizes 100,000 shares of no-par stock, the temptation for the clients probably will be to issue a large number of those shares. If the total number of outstanding shares increase beyond 740, the corporation's annual franchise tax will exceed the minimum of \$50 per annum, with absolutely no corresponding value to the corporation. If the client issues all 100,000 shares, the annual franchise tax would be a whopping \$6,750.

<sup>16</sup> I make a special effort to explain that lawyers who do not take extra care to understand the implications of what they are writing may find themselves in serious trouble with their clients. I also ask students *not* to tell their friends who enroll in my class in subsequent years about this issue. So far, my students appear to have cooperated.

<sup>17</sup> I also discuss the reference in the purposes clause that purports to allow the corporation to take any action allowed under the "Corporations Act of 1947." Since that Act is long out of date and can no longer be found in the current volumes of the Arkansas Code, this phraseology creates some potentially difficult problems of interpretation. I can usually convince students of the wisdom of revising this section.

statute.<sup>18</sup> Some years, I will have one or more industrious students inform me that they called the Secretary of State's office. Those students will have discovered that the Arkansas Secretary of State requires the filing of a Franchise Tax Address Form, which is not mentioned at all in the state corporation statutes.<sup>19</sup> Nonetheless, the Arkansas Secretary of State requires a new corporation to send in a form specifying the address to which franchise tax forms are to be mailed.<sup>20</sup> The lesson to be learned from this is that if an immediate filing is a priority for the clients, it is always safer to call for confirmation about current procedures than to learn after the fact about additional requirements.

### C. THE NEGOTIATION EXERCISE

Over the years, I have tried a variety of negotiation exercises. The one I like most involves an agreement between shareholders and their corporation providing that, upon the death of any shareholder, the corporation has the right to buy back the decedent's shares for a "fair value, to be calculated based on a consideration of the book value of the corporation's assets." Despite the obvious ambiguity of such wording, my experience suggests that this type of provision is, in fact, relatively common.

A negotiation exercise, conducted by students representing both sides (the decedent's executor and the corporation) brings home some of the perils of including such ambiguities in a shareholder agreement, while emphasizing just how difficult valuation of a closely held business can be. The students are given a substantial amount of information about the fictitious company and the

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<sup>18</sup> ARK. CODE ANN. § 4-27-120.I. (specifying that any document to be filed must be accompanied by required fee and exact or conformed copy). The schedule of fees appears in ARK. CODE ANN. § 4-27-122.A.

<sup>19</sup> In fact, the corporate franchise tax statutes specify that a "newly formed corporation shall not be required to file a franchise tax report until the calendar year immediately following the calendar year of incorporation." *Id.* § 26-54-105(d)(2).

<sup>20</sup> Theoretically, aggrieved clients could file a petition seeking to force the Secretary of State to file the articles without this form. *Id.* § 4-27-126. However, the filing fee for a civil action in Arkansas is one hundred dollars, and there is certain to be delay before any such petition is decided. The reality is that it is quicker, cheaper and easier just to file the form, even though it is not required by the statute.

shares.<sup>21</sup> Four students (divided into two teams of two) are assigned to conduct the negotiations in class the following week.<sup>22</sup> They are told whether they will be representing the executor or the corporation.<sup>23</sup> The other students are told to come to class with their estimates of a fair valuation.

I start class by keeping the negotiators outside, and poll the class to find the range of values assigned as fair. I record these values, and call the student negotiators back in. I then let them sit down<sup>24</sup> and work towards a fair resolution.

During the next hour, those of us who are in the role of spectators invariably see a number of different valuation techniques being discussed and criticized. We also see a surprising range of negotiation techniques.

After the exercise is over, the class looks at the outcome in comparison to the students' pre-negotiation views about what would constitute a fair price. We also talk about arguments and techniques that worked well. Year after year, students comment either on how the preparation of one team or the other helped them make their case, or how the apparent lack of preparation hurt a team.

I hope that the exercise reinforces the value of careful preparation. I am sure that it reinforces the students' understanding of the substantive law concerning valuation, because in the years I have conducted this exercise (or one like it), student performance on exam questions dealing with valuation is significantly better than in years when I have not conducted the exercise.

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<sup>21</sup> Copies of the materials I used in 1996-97 (with updated names of a more national bent than those I typically use) are reproduced in Appendix C.

<sup>22</sup> I usually make this assignment the week before the exercise will be conducted in class. This gives the students who will be doing the exercise time to read excerpts from Roger Fisher and William Ury's book, *Getting to Yes*, which I place on reserve for them, and to come back to discuss any questions before they get in front of the class.

<sup>23</sup> The two members of each teams are allowed to meet and discuss strategy, but otherwise the students are told not to discuss the exercise with anyone.

<sup>24</sup> Again, to make sure the students speak loudly enough, I seat them at opposite ends of the room at the front of the class.

### III. CONCLUSION

I have used other exercises as well, but the ones that I describe here seem to be the most useful. In addition, my student evaluations (while still depressing at times) now at least comment favorably on these exercises. Students appreciate the effort to show them about this side of the practice of law, enjoy practicing (or watching others practice) the skills that a lawyer will need upon joining the profession, and find the exercises to be a learning experience. I do too.

## APPENDIX A

INTRODUCTORY INTERVIEW—BUSINESS ORGANIZATIONS  
BACKGROUND INFORMATION FOR “JOE COOL, JR.”

Last year, you graduated from the University, but you have been unable to find what you consider to be a satisfactory job with your degree in Psychology. You thought about law school, but eventually decided it was not for you. Unfortunately, job opportunities calling for someone with a B.A. in Psychology are few and far between, and you really do not feel like pursuing graduate school at this time.

You have spent the last year working in a major company's headquarters, where you have seen first-hand the kind of hours required of management-level employees (6:30 am to 6:30 pm, plus at least five hours on the weekend). You have doubts that you want to work on this kind of schedule, although you have made a number of friends among the management-level employees at corporate headquarters.

For the last several months, you have been considering an idea for a new business. Management-level employees have very little time to run personal errands and take care of things like basic home repairs. Since you put yourself through school working as a carpenter's assistant (and painting houses one summer), you feel that you have a pretty fair ability to handle the kinds of basic repairs (like a broken door knob, or broken window) for which busy executives have difficulty finding time.

In addition, your girlfriend put herself through school by cleaning houses. This service is also one executives need and often have a difficult time finding. Your older brother (an unemployed artist) also has a chauffeur's license, and has driven a school bus for the last few years. Finally, you have numerous unemployed and underemployed friends who would be really good at things like running errands.

You believe that there is a real and growing need for this service. Although the area has seen a steadily increasing population of management-level and executive employees, services designed to cater to their needs seem to be lagging behind. You believe you could market all types of services to management-level employees,

particularly those employees who are single or who have a working spouse.

You therefore envision forming some kind of business to facilitate the provision of these services. Your parents have agreed to invest \$10,000 to help you get started. (You've never really talked about whether this means a loan, or they want to be owners with you. You would rather they lend you the money.) You would run the business out of your condo for the time being, but, if things take off, who knows where this could lead?

You do not know who else might invest in the company, although you have already agreed with your girlfriend that she can be an owner/partner. She was too busy to come meet the lawyers, and trusts you to let her know what they say.

In addition, some of your more talented friends might also want an ownership interest in return for their skills (like Paul, the plumber, and Eva, the licensed electrician).

You have not approached any banks or other lenders. You have not taken any steps to obtain a federal employee identification number. You do not know how many employees you would have or need or whether you should rely more on independent contractors. In fact, you are not really sure about the difference between independent contractors and employees, or why it matters. In sum, there are lots of details that you have not yet decided on. You do, however, like the name "Executive Errands," or something like that, for your company.

The specific services you have thought of and know you could offer:

- basic home repairs
- basic home painting
- home cleaning
- emergency baby-sitting
- basic lawn care (although there is plenty of competition for this particular service)
- shopping (groceries, special occasion gifts, etc.)
- mailing (thank-you cards, invitations, etc.)
- helping to organize parties (making arrangements with caterers, etc.)

—errands like paying bills, picking up dry-cleaning, transporting children to school or activities

You have no particular business background, and want legal advice to help you decide what kind of business organization would be best for you and the business. You want to turn the matter over to the law firm to the maximum extent possible, after reassuring yourself that they are not going to charge too much.

## APPENDIX B

## DRAFTING PROJECT—BUSINESS ORGANIZATIONS

CERTIFICATE OF INCORPORATION OF  
TRIED AND TRUE, INC.

- FIRST. The name of the corporation is and henceforth shall be Tried and True, Inc.
- SECOND. The address of the corporation's principle place of business is 999 MFG Place, Capitol, ST 00001. The name of its registered agent is Melvin E. Snerdly.
- THIRD. The purpose of the Corporation is to engage in manufacturing activities and related activities. The Corporation shall be and hereby is authorized to act in any manner reasonably incidental to this purpose as authorized by the Corporations Act of 1947.
- FOURTH. The total number of shares which the Corporation shall have authority to issue is 100,000 shares of capital stock, having no par value. It is expressly understood, agreed and acknowledged that the shareholders shall have no preemptive rights whatsoever, of any nature.
- FIFTH. The board of directors shall consist of three persons who shall be elected annually by the shareholders. The initial board of directors of the corporation shall be the following persons and the same are hereby and henceforth installed as directors of the Corporation:  
Winthrop Xavier Wiley, III  
Francis Oldham  
Quincy St. James
- SIXTH. The name and mailing address of the incorporators are:  
Frederick Fernschlepp, Esq., 1010 Atty Ln, Capitol ST 00001  
Bertram Birdbrain, Esq., 1010 Atty Ln, Capitol ST 00001  
Melvin E. Snerdly, Jr., Esq., 1010 Atty Ln, Capitol ST 00001



SEVENTH. The undersigned expressly acknowledge, represent and warrant that subscriptions in the amount of at least \$500 have been received and will be accepted before the corporation begins operations.

The undersigned incorporators hereby acknowledge that the foregoing certificate of incorporation is their act and deed and that the facts stated herein are true. EXECUTED this \_\_\_\_ day of \_\_\_\_\_, 19\_\_.

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Frederick Fernschlepp, Esq.  
Incorporator

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Bertram Birdbrain, Esq.  
Incorporator

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Melvin E. Snerdly, Jr., Esq.  
Incorporator

## APPENDIX C

## NEGOTIATION EXERCISE—BUSINESS ORGANIZATIONS

*Basic Factual Background*

Name of Company: War Games, Inc., an Arkansas Corp.

Stockholder list:

Georgina Busch	4,000 shares
Alphonse Goer	2,000 shares
Patsy Bucknon	1,000 shares
Willy Bradley	1,000 shares
Dawn Quail*	1,000 shares
Eli Droll	500 shares
Roberta Droll	500 shares

\*deceased

Total shares outstanding: 10,000, all common par value \$.10

The corporation was formed in 1981. The initial 4,000 shares were issued as follows:

2,000 shares to Georgina

1,000 shares to Alphonse

500 shares to Patsy

500 shares to Dawn

These original investors all paid \$100 per share. At this time Georgina became President, and Alphonse became Vice President. Georgina's background was marketing and sales; Alphonse was responsible for the toy design phase of the business. Patsy and Dawn actually supervised the production of the toys designed by Al.

In 1984, desperately short of cash, the corporation sought to raise \$1,000,000 through the additional sale of shares. The new purchases were as follows:

<i>shareholder</i>	<i>new purchase</i>	<i>total shares owned</i>
Georgina Busch	2,000 shares	4,000 shares
Alphonse Goer	1,000 shares	2,000 shares

Patsy Bucknon	500 shares	1,000 shares
Willy Bradley	1,000 shares	1,000 shares
Dawn Quail*	500 shares	1,000 shares

These new shares were sold at \$200 per share.

In 1988, again short of cash, the company sold 1,000 shares of stock to Eli Droll, a longtime company employee, for \$250 per share. In 1995, as part of the divorce settlement, his wife, Roberta, was given 500 of those shares.

All shareholders (with the exception of Roberta Droll) work essentially full time at the company. In 1990, they all signed a shareholder agreement giving the company the right, but not the obligation, to buy back the shares of any deceased shareholder "at a fair value, to be calculated based on a consideration of the book value of the corporation's assets."

Description of company business: Produces toy guns, toy soldiers, and various other toys modeled after war supplies such as miniature jeeps, helicopters, tanks, munitions, etc. Most of the toys are molded plastic and painted inside the factory, which is located in Central Arkansas. The company is well established, with a number of lucrative long-term contracts. The industry is, however, highly competitive and quite sensitive to market downturns.

*Balance Sheet of War Games, Inc.*

<i>Assets</i>		<i>Liabilities</i>	
Cash	\$ 50,000	Accounts Payable	\$200,000
Accounts receivable	150,000	Bank Loan	300,000
Inventory	300,000		
Land & Bldg*	1,000,000	Liabilities	<u>\$500,000</u>
		<i>Shareholder Equity</i>	
			\$1,000,000
	<u>\$1,500,000</u>		<u>\$1,500,000</u>

\*This value is book value (purchase price less depreciation). There have been four appraisals on the land in the last two years, because

the company has been thinking about selling the land and moving to a cheaper location outside of town. From low to high, the four recent appraisals place the fair market value of the land at \$3,500,000; \$4,500,000; \$5,000,000; and \$5,500,000.

*Earnings History of War Games, Inc.*

(Earnings after expenses, including taxes)

1987	\$1,000,000	ten year average—\$2,325,000
1988	1,250,000	
1989	1,500,000	
1990	2,000,000	five year average (1990-1994)—
1991	2,500,000	\$3,000,000
1992	3,250,000	
1993	3,000,000	two year average—\$2,825,000
1994	3,100,000	
1995	3,150,000	
1996	2,500,000	

Although records for 1997 are not complete, net earnings for the first quarter of 1997 have been excellent, approaching \$1 million (and this value does not include the summer sales season or the Christmas rush; Christmas normally accounts for 25% of total annual sales). If sales continue at this rate, this will be a record-breaking year.

*Recent Offers to Purchase War Games*

There have been three offers to purchase War Games, Inc. in the recent past. All often were rejected. The offers were for a cash price, payable on closing. The offers were:

Jan. 2, 1997	\$ 9,000,000
Jan. 26, 1997	\$10,500,000
Mar. 15, 1997	\$12,000,000

*Data from Similar Businesses*

There are two similar businesses for which sales figures are available. One is a doll factory, also located in Arkansas. For each of the last three years this company had earnings of approximately \$2.8 million. Shareholder equity was approximately \$5.15 million. This company also had several long-term contracts. In October of 1996, the company was sold for \$12 million to a Japanese firm.

Another company was a wholly owned toy company located in Eastern Oklahoma. That company produced model planes and cars for children in approximately the same age group as those who would be interested in War Games' products. That company had Shareholder equity of \$4.75 million. The earnings of this company for the last five years had been rather variable, with a high of \$5 million in 1996 and a low of \$2 million in 1994. Average earnings for the last five years were \$3.5 million. This company was sold to a group of foreign investors in early 1997 for \$18 million.

*Immediate Concern*

Dawn Quail recently died, and her executor has contacted War Games, Inc., asking if the company intends to buy back the shares. The company responded affirmatively, sending a very polite letter asking the executor to suggest a fair price. The executor very politely responded that the company has more information at its disposal, and that it should suggest a price. The company sent all of the foregoing information to the executor, and asked for a meeting at which representatives could discuss the question of what a "fair value, calculated based on a consideration of the book value of the corporation's assets" would be.

NEGOTIATION EXERCISE—BUSINESS ORGANIZATIONS  
CONFIDENTIAL INSTRUCTIONS FOR THE STUDENTS  
REPRESENTING WAR GAMES, INC.

You have access to the following facts, which are not known to Dawn Quail's executor and which influence your thinking about what to do at this point.

1. The directors would very much like to buy back the stock.
2. The directors would prefer to pay a relatively low price, but are not interested in playing "hard-ball" with Dawn's executor. They have told you they do not want to insist that the land be valued at \$1,000,000 in computing the value of Dawn's stock. However, they have suggested that you might consider the facts that Dawn has a relatively small fraction of shares in a closely held business, and that this should significantly depress the value of those shares below what they might be worth if the entire business was being sold.

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NEGOTIATION EXERCISE—BUSINESS ORGANIZATIONS  
CONFIDENTIAL INSTRUCTIONS FOR THE STUDENTS  
REPRESENTING DAWN QUAIL'S EXECUTOR

You have access to the following facts, which are not known to War Games, Inc., and which influence your thinking about what to do at this point.

1. The litigation department of your firm has estimated an 18 month delay before any trial on the merits would be decided if the valuation of the shares resulted in litigation. They also estimate the potential cost of litigating the fair value at between \$30,000 - \$50,000, assuming that valuation of the stock is the *only* issue under consideration. They also stressed that costs might be higher if you have to rely on expensive expert witnesses to combat the company's experts.

2. Dawn's 31-year-old daughter and only heir has just been diagnosed with breast cancer. She has no insurance and is facing immediate medical bills, which means she is interested in a swift and certain payment.