

**SPRING '02 / 15.635 / MANAGER'S LEGAL FUNCTION
FINAL EXERCISE**

Material Covered:

From Class 17 (Going Public)
Through Class 21 (second class on Bankruptcy)

INSTRUCTIONS AND ADVICE

- 1. *Schedule and timing.*** Make arrangements with the TA to have the exam e-mailed to you at a mutually convenient time, and then within **five hours** e-mail back to the TA the completed exam. Keep a hard and computer-readable copy of your exam.
- 2. *Sources and communication among students:*** During the period the exercise is available, students may not consult with each other about the course. For the exercise, you may consult the text, the readings, and any notes prepared by you, but no other sources. (Since your answers will be evaluated in terms of the course readings and the lectures, especially the readings, consulting other sources would not likely do much good.)
- 3. *Weighting and strategy:*** There are three questions. Answer all three. They will be weighted equally. Each particular point you should address appears in a sentence ending with a “?” Don't neglect to respond to each “?”
- 4. *Format and submission of answers:*** Your answer should have a cover sheet which includes your name, “ESL” if English is your second language, and the exact word count for the entire document. Start the answer to each question on a fresh sheet. **Your entire submission should not exceed 1,500 words.**
- 5. *Some general advice (READ THIS CAREFULLY):*** You are not supposed to be a lawyer, and I don't expect you to have definite answers to legal questions. You are supposed to be a manager with the ability to make a **preliminary** assessment of legal problems. Each exam question will ask you to address legal issues in a business context from the point of view of a manager. It doesn't matter much if I don't agree with your judgment as to how serious a risk or problem is, so long as you spot it and understand the legal and managerial implications of it. Your answers should demonstrate your understanding of and ability to express broad legal concepts, and your ability to spot where and how the law will have an impact on a business problem and the individuals involved. It will not be necessary to cite specific cases or statutes. **Make sure that your answer focuses on how general legal principles apply to the facts you have been given.** To the extent that the facts are not as specific as you would like them to be for your assessment, point that out. You shouldn't concern yourself with implausible possibilities. I don't try to “trick” people in these exams. Look for the main issues suggested by the facts, and get right to them. **Be responsive in your answer; that is, answer the specific questions that have been asked from the perspective you have been asked to assume.** (For example, if you are asked to provide some alternative courses of action, do so. If you are asked to assess risk from the perspective of a particular party, do that.) Your answers should be well-organized and

clearly written. The length limit is tight, so you will probably have to edit your answers carefully to cover the necessary points in the limited space allowed.

6. Grading: If your exam is over the length limit, or submitted late, there will be a downward adjustment to your grade.

General background to all questions: You are a top executive at CleverCo., known and respected for your general management skills, and also for your modest but useful understanding of business law that you first picked up while at Sloan and have been building on ever since. You report directly to Hot Shot, CleverCo's CEO. CleverCo is one of the major manufacturers of a certain kind of radiological scanning device that is used in the medical diagnosis of neurological disorders. CleverCo first made a place for itself in this market with some software innovations which greatly improved the three-dimensional quality of the images which are the main read-out from the scans. From those beginnings, CleverCo shifted into the manufacturing of complete neurological scanners, and it now has 20% of that market in the US. Its primary competitive advantage is still in the software interface.

Question 1. CleverCo has in the past relied primarily upon trade secret protection for its software. It has also copyrighted the software under a special procedure available in the US through which software which is being treated as a trade secret can also be copyrighted without making disclosure of more than a trivial part of the software. But CleverCo is considering shifting to a patent-based strategy. The patent lawyers have indicated that the software combined with the scanner is patentable subject matter; that is, it is the kind of innovation on which a patent can be granted assuming all the other requirements of patent law (such as novelty) are met. Furthermore, the patent lawyers have done a very preliminary assessment of prior art and concluded that it is likely that CleverCo would not be precluded from obtaining one or more patents by prior art. However, Hot Shot, who has very good judgment in these matters, is a little worried that in the enthusiasm generated by these initial encouraging reports, CleverCo may not be giving sufficient weight to some of the weaknesses and costs of a strategy based on patent protection. She is also concerned that the company's patent attorney may have something of a pro-patent bias. She wants to have a meeting with that attorney, at which she will press him to help anticipate the weaknesses and disadvantages of a patent-based strategy, but before going into that meeting she wants you to help her figure out as best the two of you can what the key issues will be. What do you think may be the main weaknesses and costs of shifting to a strategy of patent-based protection for CleverCo's technology? As to these weaknesses and costs, which will be the hardest to measure or anticipate?

Question 2. One of CleverCo's major competitors in the US is TargetCo, which also manufactures a neurological scanner. Like CleverCo, these scanners are TargetCo's major product. TargetCo's software interface is not as good as the one developed by CleverCo. But several of the mechanical and electrical components of the scanners must be made to extremely fine tolerances for the scans to have maximum accuracy, and TargetCo is the industry leader in certain production processes for these components and makes what is from a mechanical perspective a superior machine. TargetCo has a 30% US market share. The other 50% of the neurological scanner market is held by two giant companies, each of which is more than a 100 times bigger than TargetCo or CleverCo, and each of whom makes a huge range of electronic devices and other products.

Hot Shot has concluded that a company which combined CleverCo's strength in software and TargetCo's strength in production would be a much stronger competitor. She has decided that it is time to think about attempting a friendly acquisition of TargetCo. The first step would be a meeting between her and the TargetCo CEO.

However, before she goes forward, she wants to think through some of the antitrust issues with you, after which she will also consult with CleverCo's lawyer. What are the antitrust problems with entering into discussions with TargetCo? How is the merger likely to be analyzed by the antitrust authorities? Are there alternatives to a merger that might provide the same business benefit but create fewer antitrust problems than the merger?

Question 3. It is six months later. The merger negotiations never went forward because it became clear that TargetCo was in financial distress, and CleverCo did not think it had the financial resources to take on a distressed partner. Hot Shot has since learned that TargetCo is hoping to find an investor or a lender who will put some money into TargetCo., and CleverCo has enough cash on hand. Assuming the antitrust laws would permit such an arrangement, Hot Shot is interested in going forward if the transaction could be structured such that, if TargetCo goes into bankruptcy, CleverCo will walk away with any process patents held by TargetCo. Is it possible to structure a cash infusion from CleverCo to TargetCo such that this result is assured? If it can't be assured, can a transaction be structured such that this result is a likely possibility? What aspects of bankruptcy law may pose problems for this strategy?