

DO NOT TURN OVER THIS PAGE UNTIL THE EXAM STARTS, BUT READ THIS SIDE
SPRING '00 - 15.615/15.647 -- THE MANAGER'S LEGAL FUNCTION
MID-TERM EXAM

1. You may have with only any readings assigned for this class and any notes prepared entirely by you.
2. Sign the attendance list and check "ESL" if English is your second language, and "647" or "615."
3. If you are typing, your answers must consist entirely of material typed during the exam – no cutting and pasting. Hand in a printed copy or a floppy labeled with your name and containing a single file.
4. Answer both questions, which will be weighted equally. Start a new bluebook or, if typing, a fresh page for each of the two questions. For typed exams, make sure your name appears on every typed page (use a header or footer) and that pages are numbered. The cover of each bluebook or the first page of the typed answer to each question should show both your name and either "615" or "647".
5. Some general advice: You aren't supposed to be a lawyer, and I don't expect you to have definitive answers to legal questions. You are supposed to be a manager with educated instincts about legal problems, including an understanding of broad legal doctrines, the ability to spot where legal issues will have an impact on a business arrangement and the individuals involved, and the ability to evaluate in a preliminary way how legal considerations shapes risks and opportunities. Each exam question will ask you to address legal issues in a business context from the point of view of a manager. It will not be necessary to cite specific cases or statutes. Make sure that, in your answer, you show that you understand general legal principles and can apply them to specific facts. If the exam question has subquestions (every subquestion will end with a "?"), respond to each subquestion, preferably in the order in which they are asked. The time constraints in this exam are tight. If you are running out of time, start outlining. I don't try to "trick" people in these exams. Look for the main issues and get to them.

FACTUAL BACKGROUND TO BOTH QUESTIONS

You are Smarty Aleck, a Sloan graduate. Four years ago, you, Dick and Jane set up HealthChoice Co. ("HCCo"). Jane is a doctor and top specialist in diabetes. She practices with three other diabetes specialists in a partnership (state law does not permit doctors to practice through corporations) called MD Partners ("MDP"). Dick has a background in the health insurance industry. You bring skills in computers, product development, and general business, and are the CEO. The three of you own the company, holding equal shares, and comprise the board. You and Dick work full time for HCCo. Jane is part-time, still working mostly with MDP.

The idea behind HCCo was that diabetes treatment has become more complex but, if done right, more successful in avoiding health complications like heart disease. Sophisticated purchasers of health care like insurance companies recognize that getting diabetes patients into the right hands can improve health outcomes and save money. However, the finest experts, like MDP, are concentrated at a few major medical centers. HCCo offers a package of services and technologies that make it possible for doctors like MDP to work effectively with patients at longer geographical distances. This package includes: video conferencing links to outpatient clinics at community hospitals; more aggressive use of enhanced home diagnostic kits (all of which were available before, but some of which are packaged specially for this program); internet-based interactive diagnostic and treatment protocols, and partial medical records, designed by HCCo in consultation with MDP, and which link together MDP/HCCo, the patients, and local providers (including a primary care physician who practices close to the patient, and often a clinical lab and home health agency); and educating patients and caregivers in the use of e-mail for routine consultations.

HCCo has been surviving on a few small contracts and one big one, with NorthEast Insurance ("NEI"), a regional carrier. Each contract is a three-way deal, among NEI, HCCo, and MDP. MDP provides the medical component, and HCCo provides the supporting services and management expertise. HCCo is surviving but not thriving – it needs capital and more contracts.

QUESTION #1

Two months ago, HCCo was approached by Granite Insurance, one of the nation's largest carriers. Granite is willing to invest four million dollars in HCCo in exchange for a non-controlling ownership share. Granite's primary interest is not direct return on its investment. Granite's primary interest is in HCCo as a "laboratory"—Granite thinks that the HCCo approach is the wave of the future for chronic disease treatment and wants to position itself at the cutting edge. HCCo is interested in this deal for the investment, and because Granite is potentially a much larger source of referrals than all of HCCo's current contracts combined. Tonight there is going to be an informal HCCo board meeting to discuss the Granite proposal. As usual, you will lead the meeting. Please prepare a memo to the file setting out your thinking on the following:

(i) Before Granite came forward, the board had agreed it would start looking for venture capital. What contractual terms would a typical venture capitalist require that would likely be different from those which Granite will probably ask for?

(ii) Assuming that Granite mostly wants to learn from HCCo, does HCCo have any intellectual property which it can or should protect, and how would it do so? If a deal with Granite goes forward but doesn't work out in the long run, is there a danger that Granite will end up with any intellectual property rights that will keep HCCo from going forward on its own, and what should HCCo do about this?

QUESTION #2:

You think that Granite might find HCCo/MDP more attractive if they are out of the NEI deal. The present three-way contract among NEI, HCCo, and MDP runs for three years from the start date, which was about 18 months ago. When the deal was being negotiated, Dick and Jane, who were the main negotiators for HCCo and MDP respectively, were very reassuring about how reliable HCCo and MDP would be, and about how well they understood the need for long-term reliability in health care. Each of the three parties put a good deal of resources into developing the internal systems needed to make the relationship work. In the contract, NEI promised its "best efforts" to encourage clinically appropriate referrals to HCCo/MDP, but there have been much fewer than any of the parties expected, because cooperation from local doctors has been lacking, and NEI isn't comfortable being too pushy with them. As a result, revenues from the contract have been disappointing.

(i) From HCCo's point of view, what are the different ways it can get out of this deal? What would be the legal risks and likely resulting cost to the company? Might any individuals have personal liability because of their connection with HCCo?

(ii) MDP is less likely to be comfortable with walking away from the NEI deal, because of the professional commitment of the doctors to continue treating patients. However, if MDP can be persuaded to cooperate with HCCo in seeking to end the NEI arrangement, and if this can be done in a medically responsible manner, are the legal risks to MDP or to any individuals associated with MDP different from the risks faced by HCCo?

(iii) There may be one further complication. About a month ago, Dick was asked outright by an executive at NEI whether there was any risk that HCCo might walk away from the NEI deal – probably the NEI executive had heard a rumor about the Granite proposal. Dick has been a bit evasive about how he answered that question, and you are going to try to get the facts. If it turns out that Dick told NEI not to worry – as you fear he did – how would that change your assessment as to the risks relating to getting out of the NEI deal?