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**THIS EXAM CONSISTS OF 8 PAGES (INCLUDING THIS PAGE)
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**THE UNIVERSITY OF BRITISH COLUMBIA
PETER A. ALLARD SCHOOL OF LAW**

SPRING EXAMINATION – April 2019

**LAW 459
Business Organizations**

**Section 2
Professor Hutchison**

TOTAL MARKS: 100

TIME ALLOWED: 3 HOURS

NOTE:

1. This is a limited open book examination. Candidates may have with them a CAN/outline and printed statutory materials. Laptops are only permitted for the use of Exemplify/Examsoft.
2. ANSWER ALL QUESTIONS.

THIS EXAMINATION CONSISTS OF 5 QUESTIONS (with sub-questions).

QUESTION 1
MARKS 20

Point Grey Capital Limited Partnership, a British Columbia limited partnership (“Point Grey Capital”), was recently founded by Jack Smith and Liam Wang, two Vancouver-area real estate investors. The partnership is engaged in the business of buying, developing, and selling real estate assets. Jack and Liam are general partners and each contributed 0.1% of the firm’s initial capital of \$100 million. The balance of the firm’s capital has been contributed by a large number of limited partners, mainly consisting of high-net-worth individuals. Pursuant to the terms of Point Grey Capital’s partnership agreement, Jack and Liam are each entitled to 0.1% of the firm’s investment profits, while the balance of the firm’s profits are to be divided among the limited partners *pro rata*. The partnership agreement and certificate of Point Grey Capital also specify that (a) no partner may transfer their partnership share without the consent of both Jack and Liam, (b) any partner may redeem their partnership share upon one year’s notice to the partnership, and (c) the partnership may not invest in any government subsidized public housing projects without the unanimous consent of the limited partners.

- (a) Jack and Liam are also co-shareholders of Point Grey Development Inc., a British Columbia company (“Point Grey Development”). Jack and Liam are Point Grey Development’s only investors and have each purchased 100,000 shares at a price of \$10 per share. Point Grey Development’s assets consist primarily of light construction equipment. Pursuant to a development agreement between Point Grey Development and Point Grey Capital, Point Grey Development provides real estate development services to Point Grey Capital in exchange for 20% of Point Grey Capital’s investment return. Assume Jack and Liam also receive additional income from other, unrelated business interests. Considering both the partnership agreement and the development agreement, do you think Jack and Liam have structured their real estate business in an optimal manner? Why or why not?
- (b) Olivia Brown, Jack’s ex-wife, is a limited partner in Point Grey Capital. Jack has been trying to rekindle their relationship and his behavior toward Olivia has become increasingly erratic and threatening. Hoping to put Jack behind her, Olivia seeks to sell her partnership share to an anonymous outside investor in order to move to Montreal and “start over.” Bitter and angry, Jack refuses to consent to the sale and says Olivia “isn’t going anywhere.” Does Olivia have any recourse as a matter of partnership law?

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- (c) Point Grey Capital has taken out several large mortgage loans to finance real estate investments. Due to regulatory and tax changes, the Vancouver real estate market begins to fall and 10 limited partners provide written notice to redeem their partnership shares, demanding repayment within no more than 6 months. Liam knows that if Point Grey Capital pays back all 10 limited partners within 6 months, it will not have enough cash to satisfy its mortgage obligations and will need to liquidate part of its investment portfolio. What will the legal consequences be if Point Grey Capital refuses to redeem the limited partners' shares?
- (d) As the Vancouver real estate market continues to fall, luxury properties—Point Grey Capital's specialty—are hardest hit. At the same time, the British Columbia government launches a housing program to subsidize the development of affordable public housing. Jack and Liam realize participating in the program may be the only way to avoid the firm's collapse and earn their investors a positive return. They present the idea to the limited partners, the vast majority of which approve investing in the British Columbia program. One limited partner refuses, however, claiming that investing in subsidized public housing is an unprofitable boondoggle. Can the limited partner be disregarded? Assuming Jack and Liam are right, does the limited partner owe any duty to approve the investment? How might Jack and Liam convince the limited partner that it would be in his *legal* interest to approve the investment?

QUESTION 2
MARKS 20

Nathan Lee, Lucas Robertson, Sophia Roy, William Macdonald, Monu Bagchi, and Samantha Horwitz are six Vancouver-based software engineers and entrepreneurs who want to start a new business. They retain you as their attorney to provide them with business organizational advice. They do not know what form of business organization they want to use, but they expect their business will acquire additional equity holders (employees and investors) in the near future. The six founders have little familiarity with the law, but tell you (in somewhat confused and imprecise terms) that they want the following rights and protections:

- (a) They want to ensure that Nate, Luke, Sophie, Bill, Mo, and Sam will share ultimate management authority over the firm.
- (b) Each founder wants the power to veto certain fundamental transactions, including business combinations, asset sales, and amendments to the business' organizational documents.

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- (c) All six founders want the ability to force the other founders to sell their equity interests if a majority of the founders agree to sell their equity interests to a particular buyer.
- (d) They want to ensure their business never produces products or services, and never contracts to provide products or services, that could infringe “human rights, including the rights to privacy and freedom of expression.”

Write the founders a brief memorandum addressing their concerns. You may discuss their concerns holistically or address each question separately, but think broadly about their business and legal needs.

**QUESTION 3
MARKS 20**

Streeterville Capital, LLC, a Delaware limited liability company (“Streeterville Capital”), is a Chicago-based private equity firm. Streeterville Capital has historically focused on U.S. investments, but has recently begun to invest in the Canadian energy industry. Streeterville Capital seeks to consolidate its Canadian investments in a new Canadian operating subsidiary, which it will then use as a vehicle for further acquisitions in the Canadian energy industry. You are serving as Streeterville Capital’s Canadian counsel. Your client, which has almost no experience with the Canadian legal system, seeks your advice on a number of issues. Assume most of Streeterville Capital’s Canadian investments are located in Alberta.

- (a) Your client tells you they want to use an Alberta limited liability company for their new subsidiary. What is your advice as to the form and jurisdiction of the new entity? Explain why.
- (b) Streeterville Capital has been purchasing an increasing amount of common shares from shareholders of Peace River Energy Inc., a privately-held federal corporation (“Peace River Energy”). Peace River Energy has two classes of shares: 90% of its shares are common shares and 10% are Series A preferred shares. One of the principals of Streeterville Capital asks you how many shares they need to force a merger and acquire the corporation. How do you respond?

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- (c) Assume Peace River Energy eventually becomes a publicly-traded federal corporation and Streeterville Capital (though an investment subsidiary) is the controlling shareholder, thereby selecting the board of directors. The Equal Society Foundation (“ESF”), a not-for-profit women’s advocacy organization and minority shareholder of Peace River Energy, submits a shareholder proposal requiring the board of directors to ensure that at least 50% of Peace River Energy’s executive officers are women. The ESF cites research suggesting that female managers tend to have more collaborative leadership styles than male managers, and argues that this would be a particularly valuable trait in an industry beset by political opposition. The directors oppose ESF’s proposal. Explain to your client the full legal implications of this proposal and suggest how to respond.
- (d) Assume that Streeterville Capital decides to conduct a sale of Peace River Energy to a strategic buyer. One of the principals of Streeterville Capital, also a director of Peace River Energy, mentions to you “don’t worry, I’ve been involved in a lot of corporate sale transactions in the U.S. – I know what our fiduciary duties are.” How do you respond?

QUESTION 4
MARKS 20

Belanger Inc., a publicly-traded federal corporation (“Belanger”), is a Canadian aerospace manufacturer. Belanger recently released the DS100, a midsize commercial airliner. Unlike most commercial airliners, which use outsourced engines, the DS100 uses “next generation” jet engines designed and built by Belanger itself. Belanger claims these engines are cheaper to manufacture, provide superior performance, and produce 50% less greenhouse emissions than traditional jet engines. To fund development of the DS100, Belanger raised capital by selling stock to the Canadian government and the Earth Defense Foundation (“EDF”), a not-for-profit environmental organization that invests in environmentally beneficial businesses in order to combat climate change. Following this capital raise, the federal government owns 20% of the shares of Belanger and EDF owns 15%. A year after the DS100 goes on sale, it is revealed that Belanger’s claims as to its jet engines’ reduced emissions are completely false—apparently, Belanger engineers used fraudulent techniques to “cheat” during the engines’ emissions tests. The board of directors of Belanger had no direct knowledge of the fraudulent emissions tests, as they relied on the (erroneous) technical reports of Belanger’s chief engineering officer. Following disclosure of the fraud, the stock price of Belanger falls by 30% as investors fear the company will be subject to significant government penalties. Belanger issues a public apology for the fraudulent emissions testing, which it blames on rouge engineers. It also issues new, corrected emissions results. However, even if it becomes subject to government penalties, Belanger plans to continue to sell the DS100, which is actually highly profitable.

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- (a) The EDF brings an oppression-remedy claim against Belanger relating to the fraudulent emissions testing and the continued production of the new engines. Assess the merits of EDF's claim.
- (b) Capital Ville-Marie Inc., an investor in Belanger, claims that the directors violated their duty of care. Assess the viability of this claim.
- (c) It becomes revealed that the federal government knew of the emissions cheating in advance, but delayed disclosure in order to formulate a regulatory response to "protect jobs." Facing a 30% loss on its investment, Harbourfront Capital Inc., a shareholder of Belanger, seeks to sue the federal government in its capacity as a shareholder. Can the investor prevail (assume sovereign immunity does not apply to the federal government in this case)?
- (d) In order to address the ongoing public-relations fallout from the emission cheating, Belanger retains the lobbying and public-relations firm of Gagnon Limited Partnership, an Ontario limited partnership ("Gagnon"). Working closely with the directors, Gagnon provides Belanger with lobbying and consulting services that are remarkably successful in mitigating public outrage against Belanger. For its services, Gagnon charges Belanger \$100,000, which represents a significant discount from Gagnon's standard fee rate. Later, it becomes revealed that one of the directors of Belanger is a limited partner of Gagnon, which the director never disclosed to the rest of the board. Centretown Capital Inc., an investor in Belanger, is considering taking legal action against the director. Assess the viability of this claim.

QUESTION 5
MARKS 20

Telestar Inc., a federal corporation (“Telestar”), is a publicly-traded designer and manufacturer of digital communication equipment. Telestar shares trade at a relatively steady price of \$20 per share. Xiang Qian Company, a Chinese company (“Xiang Qian”), seeks to acquire Telestar in a strategic acquisition. Xiang Qian offers to acquire Telestar by way of an all-cash amalgamation in which Telestar shareholders would receive \$32 per share. Telestar management refuses to open discussions with Xiang Qian, citing credible media reports and warnings from the U.S. government that the company has ties to the Communist Party of China and has aided the Chinese government in spying on Canadian citizens. In response, Xiang Qian launches an all-cash tender offer for 100% of Telestar’s shares at a price of \$28 per share.* Telestar’s board of directors convenes a special committee of independent directors, which immediately adopts a shareholder rights plan in order to buy time. Due to the fast-moving nature of the process, Telestar’s shareholders do not formally approve the shareholder rights plan, though several large shareholders express public support for it. Telestar begins canvassing the market for other potential buyers, but given the specialized nature of Telestar’s products, many analysts doubt the company will find another bidder. Insulted by Telestar’s refusal to negotiate, Xiang Qian states that under no circumstances will it raise its bid above \$28 per share.

- (a) South Portage Capital Inc., an investor in Telestar, claims the Telestar directors violated their duty of care in spurning the *original* amalgamation offer from Xiang Qian. Assess the viability of this claim.
- (b) Assume the shareholder rights plan remains in place for 105 days and no other bidder has come forward. Eau Claire Capital Inc., an investor in Telestar, seeks to enjoin the shareholder rights plan in the Court of Queen's Bench, claiming the directors are violating their fiduciary duties. In response, the directors argue that, as a Canadian corporation, it would be unpatriotic for them to allow the company to be sold to a Chinese firm, particularly given the allegations of Xiang Qian’s involvement in espionage and the sensitive nature of Telestar’s products, which are used in Canada’s internet backbone. The directors further emphasize that allowing Xiang Qian to acquire Telestar would significantly damage Telestar’s market reputation in Canada. Will the investors prevail in their claim? Explain why or why not.
- (c) Jasper Avenue Capital Inc., an investor in Telestar, seeks a cease-trade order from the Alberta Securities Commission enjoining the shareholder rights plan. The directors present the same basic defense described above. Will the commission grant a cease-trade order? Explain why or why not.

* Assume Xiang Qian’s tender offer is in compliance with Canadian securities regulations.

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- (d) Assume Telestar begins buying its shares on the open market to boost its share price and make Xiang Qian's tender offer relatively less attractive. These buybacks increase Telestar's share price, but also deplete its cash position. Without cash reserves, Telestar is at risk of failing to meet interest payments on an outstanding \$100 million secured loan. Mountain Bank, the lender, brings an oppression-remedy claim, arguing that, although not prohibited by the terms of its credit agreement, the buybacks are inconsistent with Telestar's past practices and the directors should have considered Mountain Bank's interests. Telestar argues that (i) its situation has dramatically changed since it initially took out the loan, (ii) the corporation's very existence is at stake, and (iii) if the bank wanted stronger restrictive covenants, it should have negotiated for them when it made the loan. Will the bank prevail in its oppression-remedy claim? Explain why or why not.

END OF EXAMINATION