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**THE UNIVERSITY OF BRITISH COLUMBIA  
PETER A. ALLARD SCHOOL OF LAW**

**SPRING EXAMINATION – APRIL 2019**

**LAW 461  
Corporate Transactions**

**Section 1  
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 calculator. Laptops are only permitted for the use of Exemplify/Examsoft.
2. **ANSWER ALL QUESTIONS. THIS EXAMINATION CONSISTS OF 23 QUESTIONS (in 2 parts).**

**PART 1**  
**MARKS 40**

Answer the following questions in approximately three sentences or less. Each question is worth two marks.

1. How can information asymmetry result in market failure?
2. Why do venture capital investors often demand that founders accept “vesting” stock (e.g., stock options, restricted stock, etc.)?
3. Assume the risk-free interest rate is 2.38% and the total stock market return is 9.07%. Automotive Inc., a publicly-traded automotive company, has a beta of 1.31. What is the return on Automotive Inc. stock?
4. The stock price of Energy Inc., a publicly-traded energy company, has increased by 10%, 13%, and 15%, respectively, for the last 3 years. Based on its recent stock-price performance, your friend tells you investing in Energy Inc. stock is a “sure thing.” How do you respond?
5. According to modern financial theory, how can increasing a company’s leverage increase management performance?
6. Biotechnology Inc. issues bonds that pay a variable interest rate based on the annual profits of the company. In addition, pursuant to the bonds’ indenture, the principal of the bonds increases if the value of the company’s stock reaches certain multipliers (doubles, triples, etc.). The indenture also includes restrictive covenants preventing the company from issuing any senior debt. Bondholders cannot vote in general corporate elections, but have the right to veto certain fundamental changes to the company. Biotechnology Inc. plans to deduct interest on the bonds from its profits for corporate income tax purposes. Assume you are legal counsel to Biotechnology Inc. Do you see any issue with this plan?
7. Finance Inc. enters into an amalgamation agreement to acquire all of the shares of Telephony Inc. Pursuant to the terms of the amalgamation agreement, Finance Inc.’s obligation to close the deal is conditional on the absence of a “material adverse effect.” Assume that, prior to the closing, communication law changes in a manner that is materially adverse to Telephony Inc.’s business. Do you think this constitutes a material adverse effect?
8. Mary, an angel investor, purchases a SAFE (simple agreement for future equity) from Logistics Inc. for \$75,000. The valuation cap is \$2,500,000 and the discount rate is 80%. Logistics Inc. subsequently closes a Series A preferred stock financing round that values the company at four million dollars. In exchange for her SAFE, what percentage of the pre-money equity in the company is Mary entitled to?

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9. Five entrepreneurs form a corporation together, each purchasing twenty percent of the corporation's stock. Each founder wants the right to veto any fundamental change (such as an amalgamation). What is the best way for the founders to give themselves these rights?
10. What is a "drag-along" provision?
11. Give three potential advantages of structuring a corporate acquisition as a share purchase.
12. Wholesale Inc. enters into an amalgamation agreement with Retail Inc. Retail Inc. has three classes of shares: common shares; Class A preferred shares; and Class B preferred shares. Pursuant to the amalgamation, Retail Inc.'s common shares and Class A preferred shares will be exchanged for \$18 worth of common shares of Wholesale Inc., while its Class B preferred shares will be exchanged for \$12 cash. What shareholder approvals must Retail Inc. obtain to approve the amalgamation?
13. Eastern Industry Inc. plans to combine with Western Industry Inc. under a plan of arrangement. Although the two companies will combine under the plan of arrangement, the common stock of Eastern Industry Inc. will be unaffected by the transaction. Will a Canadian court require a separate vote of Eastern Industry Inc.'s common shareholders to approve the plan?
14. What is the most common (and most important) structural difference between private-company purchase agreements and public-company purchase agreements? Briefly explain why.
15. What is "sandbagging"?
16. What standard of evidence must the government satisfy under the *Investment Canada Act* to block an acquisition as injurious to national security?
17. Provide three specific ways in which National Instrument 62-104 changed the regulation of take-over bids in Canada.
18. Briefly explain how a shareholder rights plan makes acquisitions more expensive for hostile bidders.
19. Why do courts permit reasonable break-up fees? Why do they prohibit unreasonable break-up fees?
20. Media Inc., a publicly-traded media company, launches an all-cash hostile tender offer for Infrastructure Inc., a publicly-traded technology company, at a price of \$20 per share. Following announcement of the tender offer, the market price of Infrastructure Inc. increases to \$22 per share. What is the most likely explanation for this price movement?

**PART 2**  
**MARKS 60**

Answer the following questions. Each question (1, 2, and 3) is worth 20 marks.

1. Western Capital Limited Partnership, a Canadian private equity firm, seeks to acquire Software Inc., a privately-held Canadian software company, in a friendly transaction valued at \$80 million. Legal counsel to Western Capital Limited Partnership drafts the initial share purchase agreement, including a standard “conduct of business” covenant. In response, legal counsel to Software Inc. provides a substantially redrafted covenant, claiming Software Inc. needs the flexibility to pay certain cash “bonus dividends” to its founders prior to the closing. Assume the founders of Software Inc. will be remaining as managers of the company following the closing. The redrafted provision reads as follows:

Conduct of the Business. Without the consent of Buyer, not to be unreasonably withheld, conditioned, or delayed, Seller shall not: (a) conduct the Business other than in the ordinary course of business, in accordance with the terms and conditions of this Purchase Agreement; (b) except as may be permitted or required by business necessity, contractual commitments, or previous agreements or understandings with any Seller Employee, modify the compensation or benefits payable or to become payable to any Seller Employee; (c) take, or cause to be taken, any action that would interfere with the consummation of this Purchase Agreement or the transactions contemplated hereby; (d) except as may be permitted or required by clause (b) above, take any action that is intended or is reasonably likely to result in (i) any of its representations and warranties set forth in this Purchase Agreement being untrue at any time at or prior to the Closing or (ii) any of the Closing conditions set forth herein not being satisfied; (e) other than sales, transfers, or conveyances of assets to Seller Employees, sell, transfer, convey, or encumber any assets outside the ordinary course of business; (f) terminate or materially amend any Material Contract; or (g) apply for, consent to, or acquiesce in the appointment of a trustee, receiver, or other custodian for itself or any property thereof, or make a general assignment for the benefit of creditors, or, in the absence of such application, consent, or acquiescence, take any action to authorize, or in furtherance of, a trustee, receiver, or other custodian being appointed for it or any property thereof, or commence any bankruptcy, reorganization, debt arrangement, or other case or proceeding under any bankruptcy or insolvency law, or any dissolution or liquidation proceeding. Until the Closing, Seller shall: (i) preserve its business organization; (ii) maintain all licenses and insurance related to the Business; (iii) use commercially reasonable efforts to preserve its current relationships with customers, suppliers, and other business partners with which it has business relations in connection with the Business, (iv) use commercially reasonable efforts to maintain the continuing availability of the management services of the Seller Employees, unless any such Seller Employee leaves the employ of Seller; and (v) maintain its books and records consistent with past practice.

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- a) Imagine you represent Western Capital Limited Partnership. How would you respond to this section? What arguments would you use to negotiate more favorable terms for your client?
  - b) Now switch roles and imagine you represent Software Inc. How would you respond to the answer you just gave above? What arguments would you use to negotiate more favorable terms for your client?
  - c) What is the economic function (or functions) of this section?
2. Eastern Capital Limited Partnership, a Canadian private equity firm, seeks to acquire Chemicals Inc., a privately-held Canadian chemical and industrial materials company, in a friendly transaction valued at \$200 million. Both parties have retained sophisticated business law firms. Legal counsel to Eastern Capital Limited Partnership is drafting the initial share purchase agreement.
  - a) Imagine you represent Eastern Capital Limited Partnership. What is the package of (i) survival periods, (ii) baskets and cap(s), and (iii) fundamental representations (if any) that you will include in the initial draft? Briefly explain why.
  - b) Now switch roles and imagine you represent Chemicals Inc. How would you respond to the answer you just gave above? Briefly explain why.
  - c) What is the economic function (or functions) of indemnification?
3. Although British Columbia has a dynamic startup community, lack of venture capital funding is a well-known problem. The BC government wants to increase the amount of venture capital funding to promote the creation and development of high-technology companies in BC. To achieve this goal, the government creates "TechStartupFund" (TSF), a publicly-funded investment fund that will invest taxpayer money in BC startups. Regional companies will apply for TSF funding and be selected on a competitive basis. The initial draft of the TSF legislation includes the following features:
  - a) In order to ensure public funds are fairly distributed to companies with the greatest need, only companies that have *not* already received funding from private venture capital investors may receive TSF funding.
  - b) In order to ensure TSF invests in high-quality companies, the fund will only invest in companies with expected revenue growth of at least 25% per year. To determine which companies satisfy this growth target, TSF will use companies' own financial projections.

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- c) In order to ensure against unfair discrimination in the application and selection process, the personal identities of an applying company's founders (including educational background, work experience, and prior entrepreneurial record, if any) are not revealed to TSF staff until *after* a funding decision has been made.
- d) In order to ensure against any conflicts of interest in the application and selection process, TSF investment decisions will be made by government employees whose salaries are unaffected by the performance of TSF-funded companies or the return on TSF's investments.
- e) In order to ensure greater economic equality for all British Columbians, no employee of a company receiving TSF funding (including the company's founders) may earn more than five times the median annual household income in BC (\$82,110), whether in the form of salary, capital gains, or the exercise of stock options or restricted stock.

Imagine you are acting as a consultant to the BC government. Are there any changes to the proposed legislation that you would recommend? In your answer, you may consider different ways to achieve the government's various policy goals and/or whether all of those goals are necessarily worth pursuing.

**END OF EXAMINATION**