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

FINAL EXAMINATION – APRIL 2020

LAW 459.002
BUSINESS ORGANIZATIONS

PROFESSOR LIWEN LIN

EXAMSOFT PASSWORD:
EXAMSOFT RESUME CODE:

TOTAL MARKS: 100

WRITING TIME ALLOWED: 3 HOURS
PREPARATION TIME ALLOWED: 10 MINUTES

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PART I: SHORT-ANSWER QUESTIONS [40 MARKS]

This Part includes 8 short-answer questions. Each question is worth 5 MARKS. Please keep your answers concise. Do not spend too much time on each question (approximately no more than 10 minutes). If necessary, you may cite relevant statutory sections and court cases to support your answers.

Assume all the corporations in the following questions are incorporated under the CBCA; assume all the partnerships in the following questions are governed by the BC Partnership Act.

QUESTION 1.

Anna wants to open an ice cream shop but does not have enough money. She approaches Elsa, who is a certified pastry chef and has some money to invest. They agree that (1) each will have a 50% interest in the business; (2) profits and losses will be shared in accordance with each party's interest proportion; (3) ordinary business decisions will be made by Elsa while extraordinary matters will be decided jointly; (4) the business name will be *Anna and Elsa's Frozen Wonderland*. Anna is concerned with the liability as being a partner. Anna wishes to insert a provision in the partnership agreement, providing that "This relationship shall not be deemed to be a partnership." Can the provision effectively protect Anna from partnership liability? Why or why not?

QUESTION 2.

Cars Inc. has two classes of shares: common shares and preferred shares. The preferred shares are non-voting and non-redeemable. The board considers a plan of capital restructure. As a result, the board proposes to change the preferred shares from non-redeemable to redeemable. The board submits a proposal to shareholders to amend the preferred shareholders' rights set forth in the articles of incorporation. Who are entitled to vote on the proposal? Explain.

QUESTION 3.

Arlo and Buck form a business called *Good Dino LLP* to manufacture high-quality wooden toys. Arlo and Buck agree that Arlo is a managing partner responsible for the day-to-day business operations while Buck is a "silent" partner, who does not take part in the management. The business is growing steadily and in a good financial condition. In a friend's birthday party, Buck meets a procurement manager of a large retailer, who is looking for a toy supplier. Buck wishes to expand the partnership's business and spends $500 wining and dining the manager. However, the manager decides against placing an order. Buck seeks reimbursement for the expenses. Is Buck entitled to reimbursement? Why or why not?

QUESTION 4.

Ratatouille Inc. is a renowned French restaurant chain. Remy, a holder of 5% of the company's outstanding shares, is very upset about the board's employee layoff decision in response to the COVID-19 crisis. He sends a letter requesting the board to retract its layoff decision. The board does not respond. Then Remy requisitions the board to call a special shareholder meeting to discuss and approve the company's human resources strategies amid the pandemic. After waiting 21 days with no response from the board, Remy himself calls a shareholder meeting. The board argues that the shareholder meeting is unlawful as the subject matter placed before the meeting is entirely within the board's management discretion. <u>Is the board's argument correct? Why or why not?</u>

QUESTION 5.

Snow White and her seven friends form a partnership named *The Red Shoes* to design, manufacture and sell luxurious shoes. The firm has a group of loyal customers because of Snow White's reputation. Palace Inc., a branded shoe company, invites Snow White to join as Chief Design Officer. Snow White accepts the job offer and withdraws from the partnership. To maintain the firm's good status in the industry, the remaining partners pass a resolution to keep Snow White's withdrawal confidential. Nevertheless, the partnership's business is declining after Snow White's withdrawal. Some of the partnership's suppliers who have been doing business with the firm for many years try to hold Snow White accountable for overdue payments. <u>Is Snow White personally liable to the suppliers? Why or why not?</u>

QUESTION 6.

Simba and his friends plan to create a company named *The Lion King*, providing custom designed safari adventures. Simba on the behalf of the yet-to-be-formed company enters into a lease agreement with Zazu. On signing the agreement, Simba pays the deposit and the first month's rental. Then Simba signs and files the articles of incorporation. After the issuance of the certificate of incorporation, the staff move into the leased office and start the business. As Zazu does not receive the second month's rental, he calls the office and demands the payment. Simba's secretary tells Zazu that the board will hold a meeting tomorrow to ratify the contract and he will receive the payment shortly. However, the broad meeting does not take place and the rental remains unpaid. Zazu argues that Simba is accountable for the overdue payment as he is a promoter. <u>Is Zazu's argument correct? Why or why not?</u>

QUESTION 7.

Bogo, Judy and Nick operate a pet store named *Zootopia LLP*. Each partner has an equal interest in the partnership. The three partners agree to share profits and losses equally. The business is profitable and has a good cash flow. One day, Bogo is on duty in the store and negligently gives contaminated food to dog clients, causing kidney injuries. Bogo uses the partnership's money to pay $90,000 for damages to the dog owners. Judy and Nick argue that they are innocent partners and have no personal liability. They argue that Bogo should use his own personal money to cover the damages, instead of paying with the partnership funds and thus sharing the damages with other partners. <u>Are Judy and Nick correct? Why or why not?</u>

QUESTION 8.

Sam, Mikaela and Lennox form an automobile salvage business, *Transformers Limited Partnership*. Sam is the general partner while Mikaela and Lennox are the limited partners. The business buys wrecked automobiles and then rebuilds them or cannibalizes for parts. *Transformers* sells rebuilt and used parts to car dealers or service stations. Sam damages his personal truck in a car accident. He sells his truck to *Transformers* at a price 20% above the market value. Sam tells Mikaela (Sam's girlfriend) about the transaction and Mikaela agrees the sale. Lennox learns of Sam's sale and opposes it. Lennox argues that without his consent Sam should return profits made from the sale. Sam argues that Lennox as a limited partner has no say on this transaction. <u>Who is right, Sam or Lennox? Why?</u>

END OF PART I

PART II: LONG QUESTION [60 MARKS]

"Kuber" is a startup offering ride-sharing services for kids. Kuber promises a safe ride for kids to and from school, to hockey practice, dentist appointments or anywhere else time-crunched parents need. The company is licensed to operate in a number of cities in Canada.

Kuber is incorporated under the CBCA. Kuber's articles of incorporation provide that the total number of shares which the corporation is authorized to issue is 50,000.The company has 10,000 shares issued and outstanding. The company has two shareholders, Anders holding 6,000 shares and Brogan holding 4,000 shares. Both Anders and Brogan are computer scientists. Prior to starting their own business, they used to be senior software engineers at big tech companies. As they have little experience in business management and marketing, they invite Crotez, who is a senior business consultant at a renowned consulting firm, to join Kuber as a board member and a top manager. Anders and Brogan offer a generous compensation package to Crotez, including 1,000 shares to be issued and vested at the end of the first-year employment. Crotez accepts the offer and joins the company. As a result, the board is composed of three directors, including Anders, Brogan and Crotez. Anders is the chief executive officer (CEO), Brogan as the chief technology officer (CTO), and Crotez as the chief operating officer (COO).

As safety is the primary concern for customers, the board develops a list of safety features of their ride-sharing services, including rigorous background checks for drivers, car seats/boosters provided at no charge, newer and clean cars, ability to track children on their journey, escort door-to-door service, notice of a child's safe arrival, etc. However, the board recognizes that the company is unable to roll out all the safety features at once given the company's limited resources. The board has a meeting to discuss and prioritize the safety features. In the meeting, Anders and Brogan take the view that escort door-to-door service is less important as parents can track their kids through the app. Crotez has some concerns. The board passes a resolution to postpone escort door-to-door service, with Crotez abstaining.

The company burns cash quickly. The directors meet to consider financing options, including shareholder loans, bank loans, issuing shares to existing shareholders or bringing in new investors. Anders and Brogan prefer shareholder loans or issuance of new shares to existing shareholders, as they think internal financing is more convenient and less stressful than external financing. Crotez prefers bank loans as he does not have financial means to buy new shares or lend to the company and he is concerned that equity financing would dilute his ownership interests. Despite Crotez's objection, Anders and Brogan pass a resolution to raise funds as follows: a $200,000 shareholder loan extended by Anders; an issuance of 6,000 new shares to Anders and 4,000 new shares to Brogan. The shares are issued at a price based on an appraisal report prepared by an accounting firm. As a result, the company has 20,000 shares issued and outstanding.

The company's spending still far outpaces its revenue growth. Despite the previous capital input, the board eventually decides to seek external financing. The company obtains a $500,000 short-term bank loan. It also gets in touch with a number of private investors. Destine, a successful entrepreneur, agrees to invest $400,000 in exchange for 4,000 shares. Destine does not take part in the management of the company. After this round of equity financing, the company has 24,000 shares issued and outstanding.

The company spends the new funds on recruiting more drivers, hiring software developers, and advertising. The number of Kuber's app users grows exponentially, though the company is still losing money. The company plans to start another round of financing as the company burns cash at a very fast speed. Then the COVID-19 outbreak comes. The company's business plummets to near-zero as schools are shut down and people including kids are encouraged to stay home.

The board assesses the company's financial position. The board freezes hiring, temporarily withdraws advertising, lays off 20% of the company's workforce, and encourages remaining employees to take a 50% cut in salaries for 6 months. Anders as the CEO decides to lead by example and takes a pay cut. Brogan (CTO) and Crotez (COO) follow suit. Meanwhile, to mitigate the pay-cut impact on his personal financial condition, Anders in his capacity of CEO transfers corporate funds to himself on the ground that the corporation repays 30% of the shareholder loan, despite that the maturity date of the loan is still three years away. Anders later informs Brogan and Crotez about the loan repayment. Brogan and Crotez is upset about Anders' behavior; however, they still ratify the loan repayment, as they want to focus on more important challenges facing the firm.

Amid the pandemic, the company faces another financial problem. A customer successfully obtains a $200,000 tort judgment against Kuber for an injury caused by the company's failure to adopt any policy instructing drivers to take necessary steps (including the possibility of escort door-to-door help) to ensure kids' safety.

To rescue Kuber from the financial fallout, the board considers selling the company. The board receives two offers. Lyfter, a ride-sharing leader seeking to expand its market, offers to acquire the company for $5.3 million. Zumer, a reputable competitor focused on serving children and people with special needs, offers $4.8 million. Zumer agrees not to shuffle Kuber's leadership within 2 years after its acquisition. The board retains an accounting firm to evaluate the reasonable price range. The accounting firm reports the price between $5 million and $7 million. In a two-hour board meeting, Anders and Brogan favor Zumer because they believe Zumer is more consistent with Kuber's original mission. Crotez supports Lyfter as the price is higher. Crotez also recommends looking for other potential buyers. Over Crotez's objection, Anders and Brogan pass a resolution recommending shareholders to approve the acquisition by Zumer. The acquisition proposal is submitted to shareholders for a vote. Crotez's shares are vested several days before the record date of the shareholder meeting. At the meeting, Anders and Brogan vote for the acquisition while Crotez and Destine vote against it.

Various stakeholders are scrambling to protect their interests. Please discuss <u>the possible corporate law remedies and the likelihood of success</u> for the following stakeholders.

1) The bank and the judgement creditor are worried as Kuber fails to pay.

2) The dismissed employees are disgruntled.

3) Destine is upset about the company's management and concerned about his rights.

4) Crotez is disappointed about the significant dilution of his ownership interests. He seeks to maximize his financial returns.

END OF EXAM