

**THIS FINAL EXAM CONSISTS OF FIVE (5) PAGES**

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

**FINAL EXAMINATION – December 2019**

**LAW 459.003  
Business Organizations**

**Professor Carol Liao**

**TIME ALLOWED: 180 Minutes  
(plus 15 Minutes reading time)**

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**NOTES:**

1. This exam is open book. Students may bring in the course text, statutes, instructor handouts, course outlines, and any student-prepared notes, *but nothing else*. No library books or other texts are permitted.
2. This exam has three (3) parts and five (5) questions, worth a total of 100 marks. The marks are allotted to each question and suggested maximum times are also noted for each question. Total suggested times equal 180 minutes. These are only suggested times but students are advised to allocate their time accordingly.
3. If anything in any question seems ambiguous or erroneous to you, say so clearly in your answer and indicate any assumptions you are making to resolve the alleged ambiguity or error in order to address the question.
4. If you feel additional information is required to answer a question please indicate the additional information you feel necessary and explain why the additional information is necessary.
5. A reference to the “BCPA” is a reference to the *British Columbia Partnership Act*, R.S.B.C. 1996, c. 348, “BCBCA” is a reference to the *British Columbia Business Corporations Act*, S.B.C. 2002, c. 57, and “CBCA” is a reference to the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.

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**END OF EXAM INSTRUCTIONS**

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## Part I

Omar, Lisa, and Hugh had a small business, which they started in 2009, designing and manufacturing prefabricated children's playhouses, dollhouses, and treehouses in Coombs, a small community on Vancouver Island. They call the business "KidzHomez." They kept their business relationship informal and each contributed to KidzHomez on a part-time basis while maintaining other part-time jobs. All three of them had signing authority at the local bank branch on KidzHomez's bank accounts. They shared the modest profits of KidzHomez in proportion to the amount of time they each committed to the business, which could vary from month to month.

In 2014, Hugh met Wilson and they got married. Hugh decided to move to Toronto where Wilson had recently landed his dream job. He told Lisa and Omar he couldn't be part of KidzHomez anymore. Omar, Lisa, and Hugh all agreed that Hugh would have no further involvement with KidzHomez after June 30, 2014, but that Lisa and Omar could continue the KidzHomez business as before. Lisa and Omar agreed to share profits 50-50 starting after Hugh left KidzHomez.

Lisa and Omar hired Kal as an employee to do the work Hugh had been doing. Kal persuades them that with a little financing, KidzHomez could grow into a major business and make them a lot of money. In early 2015, KidzHomez borrowed \$75,000 from the local bank branch, rented bigger premises, hired two more employees, and increased production by 50%. When Lisa met with the local bank branch manager regarding the loan, all the discussion was about a loan to KidzHomez. Hugh's name never came up.

Unfortunately, the expansion soon turns out to have been a mistake. The extra supplies and salary costs, the higher rent, and the interest payments to the bank cause KidzHomez to be unable to pay its debts within 10 months. It has to cease carrying on business when the bank demands payment of its loan and it cannot pay its employees. Lisa and Omar together have personal assets of only about \$25,000, but KidzHomez owes the bank \$75,000, the landlord \$10,000, suppliers \$40,000 and employee wages of \$5,000.

Hugh has become financially successful in Toronto. He has a half interest, worth \$200,000, in the house that he and Wilson jointly own, and an investment portfolio worth \$100,000. Hugh receives a letter from the bank demanding repayment of the loan to KidzHomez.

### Question One

Please answer the following questions, referring to relevant sections of the *BCPA*, and any relevant case law studied in the course. Identify any facts which must be assumed to reach a conclusion.

- (a) Was KidzHomez a partnership before June 30, 2014? [5 marks; 9 Minutes]
- (b) Assuming it was, is Hugh liable to pay the bank? [15 marks; 27 Minutes]

A small surprise injection of cash into the business has temporarily helped matters. Nevertheless, KidzHomez has really fallen into hard times. Its supplier of the prefabricated treehouses, Munkie House Ltd., is looking to collect on the debt owed to it by KidzHomez. The president of Munkie House Ltd., Allison Cameron, meets with Omar to discuss the situation and discovers that Omar and Lisa are both

contemplating declaring bankruptcy, which would immediately dissolve KidzHomez. Allison is concerned that a bankruptcy would mean Munkie House Ltd. would never be repaid. Allison agrees with Omar that, going forward, Munkie House Ltd. will be paid 20% of the profits of the business until the debt plus interest is paid off. Since KidzHomez will continue to need its regular supply of prefabricated treehouses from Munkie House Ltd. in order to continue making a profit from that revenue stream, Allison agrees to continue supplying KidzHomez and any additional debts will be added to the existing debt in the hopes that the total amount of debt will eventually shrink over time. Thus, the period in which the total amount of debt will be paid off by KidzHomez is indeterminate. Allison would also like to be consulted if KidzHomez ever considers any major strategic business moves again, in order to ensure KidzHomez will avoid future business disasters. Omar appreciates Allison's wise counsel and agrees that he will check in and get Allison's approval before any "major" decisions proceed.

A year later, a debt collection agency, hired by another one of KidzHomez's major suppliers, wants to collect on amounts owed by KidzHomez to the supplier, which are now six months overdue.

### Question Two

Upon learning about the arrangements between Munkie House Ltd. and KidzHomez, the debt collection agency contends that Munkie House Ltd. is a partner in KidzHomez and liable for the debt owed. Please discuss the likelihood of success in this claim, referring to any relevant sections of the *BCPA*, and any relevant case law studied in the course. **[15 Marks; 27 Minutes]**

### Part II

Amber and Chi hold all the shares of Cuddy Tritter Inc. ("CTI"), which was incorporated under the *CBCA* in 2012. The articles provide for one class of common shares, an unlimited number of which are authorized. Each of Chi and Amber hold 100 common shares of CTI for which they paid \$0.10 per share when CTI was newly incorporated. The articles provide for a maximum of two directors, and Chi and Amber have a written agreement in which they agree to vote their shares so as to elect each other as directors. Amber was duly appointed President and Chief Executive Officer, and Chi was duly appointed Chief Operating Officer. There are no other officers. The by-laws provide that the President may call a meeting of directors and the annual or a special meeting of shareholders.

CTI's business is in the manufacturing of high end cameras, optical equipment, and accessories. CTI needs more capital to finance expansion of its manufacturing facilities overseas to meet demand and maintain its market share. It can borrow some of the funds from a bank, but the bank insists that it increase its share capital too. Sela is willing to invest \$1 million in exchange for the issue to her by CTI of 1 million shares. Although her shares will be non-voting, Sela wants her shares to have the exclusive right to elect a third director each year. She also wants her shares to have the right to a cumulative annual dividend of \$0.10 cents per share, (\$100,000) before Amber and Chi may receive any dividends on their common shares. She wants priority for return of her capital paid up on the shares before Amber and Chi are entitled to share in any surplus, if CTI is liquidated and dissolved. Amber and Chi are in agreement with these conditions, but want CTI to have the right to buy back (or "redeem") Sela's shares for \$1 million plus any unpaid annual dividends no later than the 5<sup>th</sup> anniversary of the issue of the shares to Sela. Sela agrees to this last term.

### Question Three

- (a) Describe the process of implementing the above agreement among Sela, Amber, and Chi. Advise on the simplest way to do this. **[15 Marks; 27 Minutes]**
- (b) Is Amber and Chi's voting agreement valid? Would it be valid (before Sela becomes a shareholder, for the purposes of this hypothetical question) if it also provided that as directors they will always vote to approve an annual bonus to each senior officer of no less than 25% of the net profits of CTI before any dividend may be paid? **[6 marks; 11 Minutes]**

The agreement has been implemented and Sela has subscribed \$1 million for the 1 million shares and elects herself as a director. CTI begins the expansion of its manufacturing facilities.

At the end of the first year, there are no profits as the interest payable on the bank debt is significant and the new manufacturing capacity is not yet operational, so sales have not increased. Accordingly, the cumulative dividend on Sela's shares isn't paid.

Ten months later, the new manufacturing facilities are up and running and CTI is clearly going to have significant profits in this second year since Sela invested the funds. Chi receives an offer from a competitor to purchase the business assets of CTI for a very attractive sum. Mindful that Sela will be entitled to a second dividend payment if the second financial year closes before her shares are redeemed, Amber calls a directors' meeting (in full compliance with CTI's by-laws) to pass a resolution to accept the offer. The offer is for \$6 million for all the assets and undertaking of CTI; \$2 million immediately, with the balance on closing of the purchase and sale which is scheduled for three months later. The offer is accepted by unanimous resolution of the board.

Amber then moves, to Sela's surprise, that the shares held by Sela be redeemed by CTI for their issue price of \$1 million plus the unpaid cumulative dividend of \$100,000. Amber and Chi vote in favour; Sela dissents. The shares are redeemed and cancelled, and a cheque is delivered to Sela for \$1,100,000 as soon as the \$2 million deposit is received from the purchaser.

### Question Four

Sela feels she has been wronged. Her \$1 million capital was used by CTI for almost 11 months during the second year of the project construction, but since her shares were redeemed before the second year's financial year end, CTI is taking the position that no dividend for the second year is owed to Sela. Advise Sela as to any steps she can take, and any arguments she might raise. Assume for the purposes of your answer that CTI did not violate any *CBCA* restrictions on redemption of shares, its articles as drafted, or its by-laws, in redeeming Sela's shares. **[16 Marks; 29 Minutes]**

### Part III

Billy and Renée are two directors on the board of a Vancouver coffee company, McBeal Beans Inc. ("McBeal"). In 2010, the board of McBeal decided to acquire the assets of a small Kenyan farming

company, Ally Growers Ltd. (“AGL”), in order to gain direct access to the source material for their products, Arabica coffee beans. In the years following the acquisition, McBeal tripled its annual profits.

Prior to the acquisition and in the process of their diligence, McBeal conducted both a human rights assessment and an environmental impact assessment on AGL and found that there was much room for improvement. By its nature, coffee is a product that has the potential to create a large negative environmental and social impact. AGL’s farms were situated near the Cherangani Hills Forest, a biodiversity hotspot and home to local indigenous communities that were being negatively impacted by growing deforestation to make way for sun coffee plantations, leading to water contamination by pesticides and herbicides, erosion, and loss of habitat. As well, improved fertilizer and water use, and growing different plant species alongside coffee (as a form of farming diversification) were some of the many ways in AGL could reduce its carbon footprint, though at a significant expense.

The board has recently welcomed a newly elected director, Ling. Ling turns out to be very active director on the board, insisting that McBeal pursue an aggressive route to being a carbon-neutral coffee company given growing climate-related risks and greater public consciousness of those risks. Billy sees the need for McBeal to move towards being a more socially and environmentally conscious business, but would like a more measured approach, taking into account profit margins and the needs of other stakeholders in the business. Renée believes McBeal should obey the law, and thinks that implementing any business plan that moves beyond the focus of creating profit for the company would be in violation to their fiduciary duties and expose McBeal to greater and unnecessary business risks. The board is unsure at this point how to proceed on the issues and would like some advice on the legal parameters in which they are to make a decision.

#### **Question Five**

(a) Please provide a memorandum addressing whether the board has a legal obligation to consider the social and environmental impacts of McBeal’s corporate activity (beyond the regulatory compliance of existing laws). Please ensure that you address the arguments and counter-arguments, and the relevance of any statutory and common law considerations that have been covered in the course. **[16 Marks; 28 Minutes]**

(b) Please provide separate legal advice to (i) Ling; (ii) Billy; and (iii) Renée in regards to their positions and any recommendations on how they can ensure they are acting within the scope of their fiduciary duties. **[12 Marks; 22 Minutes]**

**- END OF EXAMINATION -**