

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

FINAL EXAMINATION – APRIL 2021

LAW 508D.002
Business Organizations

Professor LIWEN LIN

EXAM PASSWORD: VrqPYw
RESUME CODE: B15328

TOTAL MARKS: 100 MARKS

(8:50 AM PDT) **PREPARATION TIME ALLOWED: 10 MINUTES**

(9:00 AM PDT) **WRITING (INCLUSIVE OF READING) TIME ALLOWED: 3 HOURS**

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9:00 AM Exam Writing Time – At 9:00 AM, you may proceed past the **STOP SIGN** in Exemplify and begin typing your exam answers. Students are required to calculate and monitor their own time for writing exams. All exam answer uploads will be monitored to ensure that typing of answers only occurred during the allotted Exam Writing Time.

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If you think you have discovered an error or potential error in a question on this exam, please make a realistic assumption, set out that assumption clearly in writing for your professor, and continue answering the question. Do not email your professor or anyone else about this while the exam is in progress.

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PART I: SHORT-ANSWER QUESTIONS [45 MARKS]

This Part includes 9 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 (BCPA)**.

QUESTION 1.

Gekko and Owlette see a good business opportunity to manufacture non-medical masks during the pandemic. They form a general partnership, *PJ Masks*, manufacturing and selling non-medical masks in BC. A lawyer advises them to register their business under BCPA. Gekko and Owlette forget to register. Later, a customer alleges that PJ masks are made with toxic material, triggering asthma. The customer demands *PJ Masks* and its owners to pay damages. Gekko and Owlette claim that they cannot be held personally liable because their business is not a registered partnership and they are not registered partners. Are Gekko and Owlette correct? Why or why not?

QUESTION 2.

Frozen Wonderland is an ice cream shop. The business is organized as a limited partnership with three partners. Olaf is the general partner in charge of the daily management, while Anna and Elsa are limited partners, who contribute 99% of the partnership's capital. Olaf often forgets to wash hands before returning to work. Many customers complain about getting sick after consuming the shop's ice creams and leave terrible reviews on Google and Facebook. Anna gets worried about the business as profits decline significantly. Anna hires a public relations firm to improve the shop's online reputations. The public relations firm charges a high fee as the shop has hundreds of negative reviews. Anna uses her personal money to cover the public relations expenses and seeks reimbursement by the partnership. Olaf refuses Anna's reimbursement request. Is Anna entitled to reimbursement? Why or why not?

QUESTION 3.

Arlo and Buck are general partners of *Good Dinosaurs*, a store selling stuffed animals and plush toys. They agree that Arlo is the managing partner while Buck does not get involved in daily management except for certain fundamental transactions. They also agree that Buck has no personal liability for the partnership's debts and obligations. Libby, Arlo's sister, frequents the shop and sometimes she helps customers in the store. One day, Arlo asks Libby to take care of the shop for an hour as he needs to run some errands at the bank. During the hour, when cleaning the shop, Libby negligently injures a patron. The patron demands Arlo, Buck and Libby to pay his medical bills. Who could be held liable? Arlo, Buck and/or Libby?

QUESTION 4.

Happy Fish is a pet shop. It is an LLP with three partners including Marlin, Nemo, and Dory. Marlin is the managing partner; Dory and Nemo play no role in daily management. The shop does not have an adequate system to track its pet foods inventory; as a result, it negligently sells some expired pet foods, killing some customers' pet fish. Marlin withdraws \$3,000 from the partnership's bank account to compensate the customers and records the expenses on the partnership's financial statements. After reviewing the financial statements, Nemo and Dory argue that the compensation should be charged to Marlin personally, rather than to the partnership's account. Nemo and Dory explain that they as passive partners bear no personal liability arising from Marlin's negligence in management; if the expenses (\$3000) were charged to the partnership's account, that would make them share personal liability with Marlin. Are Nemo and Dory correct? Why or why not?

QUESTION 5.

Secret Towers Inc operates an indoor playground for kids. Rapunzel is the only shareholder and director of the company. She alone manages the store without hiring any assistant. The company rents a unit in a shopping mall under a five-year lease. On average, the business makes about \$10,000 in profit (revenues less expenses) per month. She believes that she as the only owner of the business is entitled to the profits. She transfers approximately \$10,000 from the company's bank account to her personal bank account at the end of each month. She keeps meticulous records of receipts and payments, but she does not follow any corporate formalities. She never holds any shareholder or board meetings. She adopts no corporate resolution when she pays herself. The company has been struggling since closure due to COVID-19. She stops paying herself and the landlord. As the company fails to make lease payments, the landlord demands Rapunzel to pay. Is Rapunzel personally liable for the lease payments? Why or why not?

QUESTION 6.

Carl and Russell are good friends. They agree to carry on a business to design and sell fancy balloons for parties and weddings. They agree to name their business *Up to the Paradise*. They agree that Carl will invest \$100,000 and Russell will carry on the day-to-day business. Russell bargains for and Carl agrees that Russell will receive salary of \$3000 per month. Carl and Russell further agree that the profits remaining after the payment of expenses, including Russell's salary, will be split 60 percent / 40 percent, with Carl receiving the larger share. Carl thinks Russell is a good balloon designer, well-organized, and generally a diligent worker, but is not strong in business judgment. Carl does not want to get involved in management but he is anxious to have a veto power over any contracts entered into by Russell. Give advice on how Carl and Russell should organize the business to satisfy all their needs.

QUESTION 7.

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. At a virtual shareholder meeting over Zoom, Remy makes the following proposal.

RESOLVED:

Shareholders of *Ratatouille Inc.* demand the board to amend the bylaws by requiring that the board's Nominating and Governance Committee include at least one non-executive employee (i.e. an employee of the Company who is not a director or officer of the Company) candidate on its director nomination list.

WHEREAS:

Employees are assets, not expenses. Research shows that the presence of employees on corporate boards can contribute to the long-term sustainability of a company.

According to the National Bureau of Economic Research, giving workers formal control rights increases board diversity and raises capital formation.

The proposal is passed by ordinary resolution. Is the proposal binding on the board? Why or why not?

QUESTION 8.

Lion King Inc. is a boutique travel agency offering small group tours and off-the-beaten path experiences in Africa. The company has three shareholders, including Simba (holding 50% of the issued shares), Nala (30%) and Zazu (20%). All the shareholders agree in writing that they elect each other directors and vote unanimously on fundamental changes of the company. The company has been struggling since the start of the pandemic. The shareholders have disagreement on the business survival strategy. Simba and Nala plan to shut down the business altogether while Zazu hopes to shift the business focus from international travel to local tourism. In a shareholder meeting, Simba and Nala vote for a resolution to dissolve the company but Zazu votes against it. Simba and Nala argue that the resolution is passed by special resolution; however, Zazu argues that the resolution is not passed as it requires a unanimous vote according to the shareholder agreement. Which side is correct? Why?

Question 9.

Incredibles Inc. is a company 100% controlled by the Parr family. The company has only one class of shares, all controlled by the family. The family wants to invite new investors but does not want to share control. An investor is interested to invest. The investor wants a high return on its investment and a share of profits if the business becomes successful. The family agrees, but on the condition that they can buy out the investor (at a premium) if the business becomes wildly successful. What sort of provisions would you insert into the company's articles of incorporation to satisfy the family and the investor?

PART II: LONG QUESTION [55 MARKS]

Panorama Inc. is a company incorporated under CBCA. It owns and operates a number of luxury hotels across Canada. *Panorama* has only one class of shares. Anders and Brogan each own 40 percent of the outstanding shares. The rest 20 percent of the outstanding shares are held by ten individuals. The board is composed of three directors, including Anders, Brogan, and Cortez, who is an outside director. Anders is also the Chief-Executive-Officer (CEO).

In January 2020, *Panorama's* human resources department reviewed the company's employee compensation policy and found the company's compensation level significantly below the industry standard. Anders in his capacity as CEO decided to raise salaries for all employees including top managers. *Panorama's* financial department predicted that the pay raise would reduce annual net profits by 2%. The pay raise was scheduled to take effect on October 1, 2020. In a monthly board meeting, Anders gave a 10-minute presentation about the pay raise and its financial impact. Brogan and Cortez asked a few questions and then the board moved on to other items on the agenda. After the board meeting, Anders sent an email to all *Panorama* employees about the new compensation policy and its effective date. *Panorama* employees were thrilled.

In February 2020, the three directors unanimously passed a resolution to declare a cash dividend of \$2 million from earned surplus scheduled to be paid in May 2020. In the same meeting, *Panorama* Board also approved to borrow \$1 million to finance an advertising campaign by issuing debentures to be purchased at face value by *Savor Inc.*, a CBCA company operating high-end French restaurants. *Panorama* owns 80 percent of the outstanding stock of *Savor*. *Savor* has a 2-person board, including Anders and Brogan.

On the next day of *Panorama's* February board meeting, *Savor* Board voted to purchase *Panorama's* debentures at face value, despite that an appraisal report estimated that the market value would be only 80% of face value. Both the articles of incorporation and bylaws of *Savor* expressly provide that the votes of interested directors may count toward a quorum and that interested directors may vote on the concerned transaction.

In March 2020, a public health emergency was declared due to Covid-19. In April 2020, *Panorama* Board passed a resolution to reduce the declared dividend by 50% but maintain its payment schedule in May. The board also decided to continue its \$1 million advertising campaign, despite its competitors had pulled back on ads during the pandemic. *Panorama* Board believed that the travel restrictions would be lifted very soon as Canada's public health system would be very capable to handle the crisis. As part of the advertising campaign, *Panorama* offered great discounts to attract customers to their luxury resorts.

As the pandemic worsened and travel restrictions continued, *Panorama's* hotels hit a historically-low occupancy rate, despite the marketing campaign. *Panorama* directors were getting very concerned about the business prospects. In September 2020, *Panorama* Board unanimously passed four resolutions to cut the company's operating costs: (1) a resolution to temporarily stop the advertising campaign (*Panorama* had already spent 20% of the advertising funds since March); (2) a resolution to indefinitely suspend the implementation of the pay raise policy, which was originally scheduled to take effect on October 1, 2020; (3) a resolution to postpone its \$1 million swimming pool maintenance (due to shortage in cash); (4) a resolution not to renew contracts with some long-term suppliers (many of whom relied on *Panorama* as their main business source and became good friends with *Panorama* staff).

In March 2021, one year into the pandemic, *Panorama* Board explored more aggressive strategies in order to carry the company through the crisis. After hours of discussion, *Panorama* Board decided that selling its equity stake in *Savor* would be in the best interest of *Panorama*. The board retained an accounting firm to estimate the value of *Savor*. The accounting firm's appraisal report showed that *Savor* would be worth about \$18-20 million (or \$90-100 per share).

Then, Anders reached out to one of his good friends, Destine, a talented and successful entrepreneur in the tech industry but no experience in the hospitality industry. Destine expressed interest in *Savor*, as he planned to revolutionize dining experience with cool technologies. However, Destine did not want to deal with *Savor* minority shareholders. Destine suggested that *Panorama* should first buy out *Savor* minority shareholders and then he would be happy to take over *Savor* at \$95 per share.

Meanwhile, Brogan tapped into his personal network for potential buyers, one of which was Frema, CEO of a reputable French restaurant chain. Frema proposed that his company would buy *Panorama*'s stake in *Savor* for \$90 per share if *Savor* minority shareholders remained, but would increase its offer to \$93 per share if *Panorama* could in advance squeeze out *Savor* minority shareholders.

Cortez also found a potential buyer, Goodie Inc., a wholesale organic grocery company seeking to enter the restaurant business. Goodie saw good potential synergy between its food supply business and *Savor* restaurants. Goodie proposed to buy *Panorama*'s majority stake in *Savor* for \$92 per share. Goodie would be happy to buy out *Savor* minority shareholders at the same price if *Savor* minority shareholders wished to sell their shares as well. Goodie made it clear that it would be Okay if *Savor* minority shareholders preferred to stick around.

In early April 2021, Anders, Brogan and Cortez had a meeting to discuss these three proposals. They agreed that all the three business plans appear good to *Savor*, though Destine's plan seems rather risky. They determined to pursue Destine's offer mainly because of the best price for *Panorama*. After the meeting, Anders and Brogan approached *Savor* minority shareholders and asked if they would be interested to sell shares to *Panorama* at \$90 per share. All the minority shareholders, except Herka, were interested in the proposed transaction. *Savor* Board then called and held a special shareholder meeting to vote on a squeeze-out transaction – if passed, all the *Savor* minority shareholders would be obliged to sell their shares to *Panorama*. The resolution was passed by a majority of *Savor* minority shareholders. Herka, the only minority shareholder who voted against the resolution, believed that the price was unfair.

In the same month, a patron was drowned in a swimming pool in one of *Panorama*'s hotels. The death was related to poor maintenance of the swimming pool. *Panorama* reached a settlement with the patron's family to pay \$500,000.

Please discuss from the perspective of corporate law the possible remedies and the likelihood of success for the following stakeholders.

- (1) Minority shareholders, employees and suppliers of *Panorama* are very disappointed about *Panorama* Board's management.
- (2) Herka is very concerned about her own rights and interests.

END OF EXAM