THIS EXAMINATION CONSIST OF 7 PAGES
PLEASE ENSURE THAT YOU HAVE A COMPLETE EXAMINATION

THE UNIVERSITY OF BRITISH COLUMBIA
FACULTY OF LAW

FINAL EXAMINATION – APRIL 2022

LAW 459.002
BUSINESS ORGANIZATIONS

PROFESSOR LI-WEN LIN
TOTAL MARKS: 100

TIME ALLOWED: 3 HOURS

NOTES:

1. **This is an <u>open-book</u> exam. You may refer to the course materials, Poonam Puri et al., Cases, Materials and Notes on Partnerships and Canadian Business Corporations, the Canada Business Corporations Act (CBCA), and the BC Partnership Act, your written and printed notes, and printed materials downloaded from the Canvas course page. No electronic materials are permitted.**

2. **If alternative conclusions are reasonably possible, state and discuss the alternatives in your answer. If you need additional facts to answer a question, state what they are and why they are necessary.**

3. **If you think the statements of law you make in answering one question are relevant to another, and you wish to cross-reference, indicate clearly the passages to which you are referring.**

4. **You must answer ALL QUESTIONS.**

5. **Enjoy the exam and have a great summer. ☺**

I. SHORT ANSWER QUESTIONS

This Part includes 4 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

Pixarr Inc. plans to merge with Netflex Inc. Pixarr has two classes of shares: common voting shares and preferred non-voting shares. According to the merger agreement, the preferred non-voting shares will be cashed out in the transaction (i.e. they will receive one-time cash and will no longer be shareholders of the company) while the common shares will be converted to new shares of the combined company. <u>Which shareholders of Pixarr are entitled to vote on the merger? Based on which rules under the CBCA?</u>

QUESTION 2

Nemo is a director of Reef Inc., a public corporation. Ocean Inc. has been actively acquiring Reef's shares in the open market. In fear of change of control, a majority of Reef's board members including Nemo pass a resolution to adopt a poison pill. Ocean as a shareholder launches a derivative action against Reef's directors, challenging their resolution. Reef's bylaws provide that "the company shall indemnify an individual in respect of expenses reasonably incurred by the individual in connection with defense of any legal proceeding to which the director is subject because of the individual's association as a director or an officer, regardless of the final determination of the proceeding." The result of the litigation is still pending. Nemo demands Reef Inc. to advance money for relevant litigation expenses. <u>Will Nemo be successful in making this request? And why?</u>

QUESTION 3

Peter Parker is a limited partner of Spider Machinery Limited Partnership. Without informing other partners in advance, one day Parker signs a contract in the company's name with Marvelous Stationary Corp. for one-year office supplies. Marvelous Stationary knows Parker as a limited partner of Spider Machinery through Marvelous' other customers who do business with Spider Machinery. <u>Is Spider Machinery bound by the contract? Why or why not?</u>

QUESTION 4

Lion King Inc. has five shareholders including Simba and Nala. Simba and Nala make a written agreement that they will elect each other as directors and appoint each other as officers at specified salaries. Is the agreement between Simba and Nala valid? Why or why not?

II. LONG QUESTIONS

QUESTION A

KidKloth is a manufacturer of children's apparel. It is a public company incorporated under CBCA. The company's annual revenue is $100 million with a gross profit of $ 20 million. Alice is the founder of KidKloth and owns 65% of its single class of shares. KidKloth's board of directors is composed of 3 directors: Alice, Bill (who is also a director of a prestigious real estate investment company, Prosperity Inc., incorporated under CBCA), and Chloe (who is an accounting professor at a university).

Since KidKloth's founding, Derrick has been its CEO. Because of his personal philosophy, KidKloth under Derrick's leadership only manufactures high-quality children apparel – safe to kids, friendly to the environment, and 100% made in Canada. As a result, the company's products are at least 50% more expensive than comparable products in the market. While over the years KidKloth remained profitable, its profits were slowly declining. For several years, Bill pressured the board to change its strategy and outsource all its production to Mexico or other low labor cost countries. Bill estimated that this strategy shift would reduce the company's operating costs by at least 30%. In the face of the increasingly fierce competition in the global children apparel market, Derrick eventually was convinced. In January 2020, Derrick instructed a management team to develop an overseas outsourcing plan.

Due to the outbreak of COVID-19 since March 2020, the board and Derrick decided to delay the outsourcing plan. With the lifting of travel restrictions, in March 2022 Alice and Bill went on a 10-day business trip to visit some potential suppliers near Mexico City, Mexico. On the second day of the trip, the directors had a meeting at a hotel with Daniel, CEO of an outsourcing consulting firm. Daniel provided a list of potential suppliers and analyzed the strengths of each supplier. In the meeting, Daniel also said: "In addition to outsourcing to these Mexican suppliers, I think setting up your own factory here is a great idea. Actually I can recommend you an investment opportunity. I know there is a parcel of land for sale in the nearby industrial district. Your company can purchase the land and build your own factory. Even if you don't plan to build anything, I think that's still a good real estate investment."

A week after the return of the trip, the board of directors of KidKloth had a 3-hour meeting discussing the company's plan to outsource to Mexico. Chloe abstained herself from voting by claiming that she did not take part in the trip and thus did not know the details well enough. Alice and Bill agreed that the company will gradually phase out its manufacturing in Canada. The board also discussed and passed a resolution on the policy of shortlisting the suppliers and which line of products would be first outsourced to the Mexican suppliers. In the same board meeting, Bill mentioned the land investment opportunity in Mexico; Alice quickly dismissed it, saying that KidKloth should focus on its apparel business rather than expanding to real estate business.

In late March 2022, Bill attended the board meeting of Prosperity Inc. Bill disclosed the real estate investment opportunity in Mexico. The board of directors of Prosperity explicitly rejected the idea because the company had no plan to expand internationally. Bill then contacted Daniel to buy the land in Mexico for himself. One week after Bill's acquisition of the land, the city government announced to rezone the land into a commercial district. As a result, the land value has increased by 1,000%. Bill expects the land value will increase further as more businesses are moving to the district. He plans to wait for a year or two and then sell the land.

Patty has been a long-term shareholder of KidKloth, owning 500 shares. KidKloth's shares are trading at $10 per share. Patty is annoyed to know that KidKloth missed the opportunity to purchase the land in Mexico given that KidKloth is eagerly looking for more profits. While recognizing that KidKloth needs to generate more profits, Patty is very concerned that outsourcing to Mexico would tarnish KidKloth's good reputation. Therefore, KidKloth plans to make a proposal at the next annual shareholding meeting in June 2022. Patty asks the board to include the proposal in the management proxy circular. The proposal is read as follows:

> WHEREAS:
> The company's shareholders are concerned about the potential adverse financial impacts on the company and shareholder value as a consequence of failure to implement effective monitoring of working conditions in facilities where the company's goods are produced. Consumer boycotts, worker lawsuits, and divestiture or avoidance by institutional investors are often the response to revelations of abusive working conditions. To fully protect the company's reputation, the company shall ensure international labor protection principles are respected in its production process and avoid engaging in doing business with irresponsible suppliers.
>
> RESOLVED:
> The company is prohibited from carrying on business with any supplier that violates the International Labour Organization (ILO) Declaration on Fundamental Principles and Rights at Work.

(i) Advise Patty whether she can bring a claim (or claims) against the directors with regard to their decisions including outsourcing and investment in Mexico? Be sure to discuss: her legal grounds and the likelihood of success; the type of legal proceeding available. **[25 MARKS]**

(ii) Discuss legal issues regarding the proposal, including any legal challenge that the board of directors might raise and any advice to Patty. **[10 MARKS]**

QUESTION B

Abbey and Betty are chocolate lovers. They form a partnership for the purpose of running a chocolate shop that imports and sells exotic high-quality chocolates. Their little chocolate shop is located in downtown Vancouver, BC. They carry on business under the name “EX Chocolates.” According to the written partnership agreement, Abbey will contribute $50,000 in cash and Betty will provide all necessary labor. The partnership agreement also includes the following terms: (1) The partnership will exist for a term of four years, whereupon the partners will determine whether they wish to continue the business; (2) All the partners share profits equally; (3) Any purchase order to a vendor over $1,000 shall be approved by all the partners.

At the end of the first year of the partnership’s term, Abbey decides that the chocolate shop needs more capital to expand the variety of chocolates. Abbey therefore invites Claire to contribute $50,000 for a one-third interest in the partnership. Betty objects. Abbey apologizes to Claire but suggests that Claire’s contribution can be characterized as a loan. Claire agrees and says that she is fine with this loan arrangement so long as she will receive interest in the form of a one-third profit share during the term of the loan (which they agree will be for the life of the partnership) and be entitled to veto certain uses of her investment. The trio goes forward on that basis. Although Claire never really does any work or makes any decision, she likes hanging around the chocolate shop and chatting with customers. Her name and face are well known to those who frequent the store, including Dillon, the sole shareholder and director of Gourmet Inc., which has been EX Chocolates’ major supplier.

One day in the second year, Betty makes a phone call to Gourmet saying the shop will not continue ordering any Madagascar Vanilla because Betty herself personally dislikes it. The phone call is to make sure that Gourmet Inc. knows it as well. Abbey inadvertently overhears Betty’s phone conversation with Gourmet Inc. Abbey is angry to hear that because Madagascar Vanilla is one of Abbey’s favorite chocolates. The next day, while Betty is not at the shop, Abbey phones Gourmet and orders 20 boxes of Madagascar Vanilla for $1,200. When Abbey is making the call, Claire gives Abbey the thumbs up and says loudly “I vote for it!”. Gourmet fills the order.

A few days later, Betty takes stock of her situation. Betty hates Abbey. Betty also realizes that although she has been working full time at the shop, she will not receive any profits this year because she discovers that Abbey has spent all the partnership’s retained earnings ($40,000) on the purchase of a mini-truck from an auto-dealer, who is Abbey’s husband. The market value of the truck is about $38,000. Abbey claims that the truck will help delivery services to customers. Betty believes that she should be entitled to a reasonable salary for her hard work.

Around the end of second year, a fancy chocolate shop opens one block away from EX Chocolates. The competition reduces the partnership revenues by 30%. The partnership is now short in cash to pay its account payable, including the amount of $1,200 owed to Gourmet for the 20 boxes of Madagascar Vanilla.

(i) Would Abbey, Betty and Claire be personally liable for the $1,200 owed to Gourmet? Why or why not? **[10 MARKS]**

(ii) Betty has come to you for legal advice on the best way to protect her rights and sort out her problems with Abbey. Explain whether her wishes are legally viable and recommend any other possible legal remedies. **[20 MARKS]**

(iii) If Abbey and Betty carry on the chocolate business as a CBCA corporation in which Abbey and Betty are shareholders and directors, instead of a partnership, how does that change your answers at (ii)? What advice would you give to Betty to protect her interests? **[15 MARKS]**

END OF EXAMINATION