

THIS EXAMINATION CONSISTS OF FIVE PAGES  
PLEASE ENSURE THAT YOU HAVE A COMPLETE EXAM

THE UNIVERSITY OF BRITISH COLUMBIA  
FACULTY OF LAW

FINAL EXAMINATION – DECEMBER 2021

LAW 459.004 / LAW 508D.004  
Business Organizations  
Professor Carol Liao

TOTAL MARKS: 100

TIME ALLOWED: 3 HOURS

\*\*\*\*\*

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 four 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. Any 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.

## END OF EXAM INSTRUCTIONS

Ned is a disc jockey in Victoria. His father, Ned Sr., had been one of the pioneers in radio technology, inventing the world's first alternating-current radio tube and first battery-less radio receiver in 1925. Eager to follow in his father's footsteps, Ned has the dream of starting his own radio station. He rents some office space in Waystar Industrial Building (Waystar) in his name and sets his plan to work, using his personal savings to purchase equipment and pay the rent, about \$8,000 plus \$2,000 per month. He asks his friend Loretta to help him out with his dream, and she says she is happy to contribute \$5,000, which would help cover the cost of a badly needed Ultra HD Network AV Receiver for the future station. The sign on the office door is a wavy banner Ned had printed up at Kinko's for \$50 that says, "New WXN Radio – Coming Soon!" It hangs loosely from string at the top of the entrance door and flaps in the wind. Loretta comes by every day to bring lunch and helps Ned out around the new office doing odd jobs, such as answering the phone and accepting deliveries, while Ned is in the back engrossed in his craft.

**Question 1**

What form of business organization, if any, is at play here? Provide any relevant statutory and case law to support your arguments. Advise Ned of any potential issues.  
**[16 marks; 30 minutes]**

Ned decides to incorporate his budding radio business. He forms a new CBCA corporation, WXN Communications Inc. (WXN). Ned makes himself the sole director and shareholder of WXN and appoints himself as the Chief Executive Officer. WXN obtains its Canadian broadcasting license and meets all necessary regulatory approvals for radio stations.

Ned turns out to be quite a popular disc jockey on the BC Island airwaves and WXN begins to take off. Ned hires Melinda as the Promotions Manager, to help with WXN's growing success. He also hires Loretta as Station Coordinator to help around the office.

Melinda turns out to be a very valuable hire; her expertise in the radio business has enabled WXN to reach new heights. Other radio stations have taken notice and Ned is worried he may lose her to the competition given WXN is still a fledging radio station relative to the others. He knows Melinda's salary is less than the market as funds are tight; Loretta is receiving minimum wage for her position. Ned decides to offer Melinda shares in WXN to keep her incentivized. Ned himself holds 5,000 WXN shares, and with the help of a lawyer to ensure all necessary requirements are met, WXN issues Melinda 1,000 WXN shares.

With Loretta's superb grant writing skills, WXN applies and manages to obtain a combination of new business start-up grants, totaling around \$500,000, to allow WXN to move into a stage of hypergrowth. Seeing all the new developments at the radio station

and praise heaped upon Melinda, Loretta is unhappy with her diminished role and minimum wage salary at WXN. She had initially accepted the low pay as she felt personally invested in Ned's dream and wanted funds to be invested back into the business as much as possible, but increasingly was feeling less appreciated and more like an employee than Ned's friend who helped him out when he needed it. She asks Ned for a raise. Ned replies that WXN cannot afford it. Loretta then asks for WXN shares, just as Melinda had received. Ned currently does not want to give away any more equity ownership in WXN. Loretta reminds Ned of the leap of faith she took when she provided him \$5,000 early on in his venture, which to date she hadn't pressed Ned to return. More as a symbolic gesture in Ned's mind, he concedes to having WXN issue Loretta debt securities in WXN valued at \$5,000, with the consideration duly acknowledged as paid, and quarterly payments to be made to Loretta until the principal amount of \$5,000 plus interest is paid off (around three years). Loretta isn't entirely satisfied but agrees and acquires the debt securities in WXN (assume for the purposes of the sale all relevant securities laws have been adhered to and the transaction is valid and binding).

A few weeks later, Ned surprises Loretta by informing her that he has decided to fire her. Shortly thereafter, Loretta learns that Ned has bought a new car, an exclusive limited-edition Mercedes-Benz valued at \$350,000, which he purchased with the help of his very hefty CEO salary from WXN and an additional \$100,000 bonus he gave himself out of the WXN start-up grants.

### Question 2

Does Loretta have any recourse under corporate law? Please advise including any likelihood of success. **[28 marks; 50 minutes]**

The owners of the Waystar building are looking to sell. Ned is anxious that he may not get the same type of flexible landlords as these current owners and seriously debates purchasing the building. Unfortunately, the sticker price is too much. However, he speaks to the two other tenants in Waystar and it seems that they are also keen to buy. The two other tenants are Kendall Motorcycles Inc. (KMI) who rents 50% of the space, and the Law Offices of Roman Roy (RR) who rents 25%. The remaining 25% are WXN. The three tenants agree to purchase the building together, paying their portion of the purchase price based on the size of their space. They agree that costs incurred for their own office spaces (such as heat, water, repairs, etc.) would be the responsibility of each business, as it had been when they were tenants. The three also agree that they will share the accompanying parking lot space proportionate to their ownership. They will allocate 40 free spaces for employees at each of the businesses (split 20, 10 and 10 spaces for KMI, RR, and WXN, respectively) and the remaining 160 spaces will be pay parking spots. Any profits from the parking lot will first be used to help offset additional building and maintenance costs shared among them (such as repairing the boiler central to all their

heating), and then remaining profits, if any, would be split proportionately at 50%, 25%, and 25% for KMI, RR, and WXN, respectively.

This arrangement works well for all three parties. Four years later, Shiv Wheels Ltd. (Shiv), a supplier of KMI, is quite upset that a 15-month-old bill to KMI for \$25,000 in designer wheels continues to remain unpaid. KMI reveals that they are cash-strapped and unable to pay. Shiv seeks redress from RR and WXN, as partners of KMI.

### Question 3

Identify the likelihood of success, including any relevant statutory or case law and arguments and counterarguments, in Shiv's claim against RR and WXN. **[25 marks; 45 minutes]**

Ned's success with radio in WXN has emboldened him to expand into the telecommunications business and he needs new forms of capital to acquire the equipment, staff, and resources necessary to achieve this dream. Over the years, in addition to taking on debt, WXN creates a new class of preferred shares in WXN. With the assistance of a lawyer, WXN manages to comply with securities law requirements to avoid having to provide a prospectus or continuous disclosure documents that would otherwise have been required under securities legislation.

After meeting all necessary requirements under the CBCA, WXN now has two classes of shares: Class A and Class B.

- (1) Class A shares (from the original shares held by Ned and Melinda) have one vote per share; Class B shares are non-voting.
- (2) Class B shares have the right to an annual dividend of \$4 per share and a right to be paid \$25 per share out of the proceeds on the dissolution of WXN.
- (3) Class A shares share pro rata in the dividends and in the proceeds on dissolution subject to the prior rights of the Class B shares.

There is no authorized limit on the issuance of either class of shares of WXN.

Class B shares are offered to potential investors. Skittish since the Rogers Telecommunications scandal hit the news, many are unwilling to invest in WXN's dual class share structure without some form of control, such as a seat on the board. Ned relents, and offers five board seats, one to each new investor, in exchange for each investor acquiring 100,000 Class B shares at \$40 per share, meaning \$20 million in new capital to WXN. At the annual general meeting, voting shareholders duly vote in favour of the new proposed board. The WXN board is now comprised of six board members: Ned, Shaun, Katy, Xialing, Ronny, and Meng'er. The injection of \$20 million is a gamechanger for WXN.

Three years later, the opportunity to purchase a small digital media company, Vaulter Inc. (Vaulter), presents itself to the board. Ned is quite passionate about purchasing Vaulter, he believes it is the way of the future. The other five board members disagree, some disagreeing quite passionately as they feel Vaulter is greatly overvalued and WXN would effectively be throwing their money away. The possible acquisition of Vaulter becomes a major disagreement amongst board members. There has been a growing pattern in these three years where Ned is frequently advocating for riskier ventures (“go big or go home” is his mantra), while the other five are growing more reluctant to pursue Ned’s ideas and, particularly, opportunities that may jeopardize the existing value they have put into the business. Ned is tired of the five board members squandering exciting opportunities and seeks to remove and replace them with five new directors that share his vision.

Ned duly requisitions a shareholders’ meeting in accordance with s. 143 of the CBCA, and following the proper notice period, the voting results from the meeting are in favour of removing the five current directors and electing five new ones: Michaela, Steve, Scottie, Denise, and Antonia. These directors had been handpicked by Ned to stand for election. Ned and the five new directors then agree to purchase Vaulter Inc. as soon as possible. The newly comprised board of directors also resolve to equalize all classes so that no class holds preferential dividend or dissolution rights over any other class. A special meeting is called to approve the resolution and a special majority of all voting shareholders approve.

A few months later, the acquisition of Vaulter ends up being a complete bust – Vaulter did have an inflated balance sheet as the former five directors had suspected. Furthermore, shortly after the acquisition by WXN, the CEO of Vaulter is entangled in embarrassing litigation involving personal gambling debts and an ex-spouse which become viral news and ultimately destroys any goodwill left in Vaulter. WXN loses its entire investment in the acquisition. The fair market value of Class B shares is now a quarter of what it was prior to the purchase of Vaulter.

#### **Question 4**

Ronny, one of the directors removed by Ned, is shocked with this outcome. In his words to you, he expresses frustration over how in all his years of being a diligent director and major shareholder of WXN: (i) he could simply be removed from the board like that by Ned; (ii) then lose three quarters of the value of his shares because of Ned’s poor decisions; not to mention (iii) the loss of the preferential dividend and dissolution rights he had in the Class B shares.

Ronny has come to you for advice. Please advise Ronny on each of his concerns, including avenues he could pursue, any challenges he may encounter, and any likelihood of success. **[31 marks; 55 minutes]**

- END OF EXAMINATION -