THIS EXAM CONSISTS OF 6 PAGES
PLEASE ENSURE THAT YOU HAVE A COMPLETE EXAMINATION

THE UNIVERSITY OF BRITISH COLUMBIA
FACULTY OF LAW

FINAL EXAMINATION – DECEMBER 2014

LAW 459.002
BUSINESS ORGANIZATIONS

PROFESSOR LI-WEN LIN
TOTAL MARKS: 80

TIME ALLOWED: 3.5 HOURS (INCLUDING 30 MINUTES READING TIME)

NOTES:

1. This is an open-book exam. You may refer to the course materials, R. Yalden et al, Business Organizations: Principles, Policies and Practices, the Canada Business Corporations Act (CBCA), and the BC Partnership Act, your written and printed notes, and printed materials downloaded from the Connect course page. No electronic materials are permitted.

2. Examination booklets will not be available for the first 30 minutes. You may make handwritten notes during the 30-minute reading time to assist your comprehension of the questions.

3. 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.

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

5. You must answer QUESTION 1 and QUESTION 2 and answer one question of QUESTION 3.

6. Enjoy the exam and have happy holidays.
QUESTION 1

Baby Land is a manufacturer of children's apparel. It is a public company incorporated under CBCA. The company’s annual revenue is $30 million with a gross profit of $3 million. Alice Abbot is the founder of Baby Land and owns 65% of its single class of shares. Baby Land’s board of directors is composed of 3 directors: Alice Abbot, Bill Bernstein (who is also a director of a prestigious real estate investment company, Prosperity Inc., incorporated under CBCA), and Chloe Carter (who is an accounting professor at a university).

Since Baby Land’s founding, Abbot has been its CEO. Because of her personal philosophy, Baby Land under Abbot’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 Baby Land remained profitable, its profits were low and slowly declining. For several years, Bernstein pressured the board to change its strategy and outsource all its production to Mexico or other low labor cost countries. Bernstein estimates 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, Abbot eventually was convinced and started to consider outsourcing to foreign suppliers.

In November 2013, Abbot and Bernstein 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 Delgado, CEO of the consulting company that provided assistance in identifying the potential suppliers. Delgado analyzed the various strengths of each supplier and 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 Baby Land had a 3-hour meeting discussing the company’s plan to outsource to Mexico. Carter abstained herself from voting by claiming that she did not take part in the trip and thus did not know the details well enough. Abbey and Bernstein agreed that the company will gradually phase out its manufacturing in Canada. The board also discussed and passed a resolution on the policy of short listing the suppliers and which line of products will be first outsourced to the Mexican suppliers. The land purchase issue was not raised in the meeting.

In December 2013, Bernstein attended the board meeting of Prosperity Inc. Bernstein 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. Bernstein then contacted Delgado to buy the land in Mexico for himself. Bernstein sold the land last month (November 2014),
making a 200% return (= $1 million). The land value increased sharply because early this year the city government rezoned the land into a commercial district.

Patty Peterson has been a long-term shareholder of Baby Land, owning 500 shares. Baby Land's shares are trading at $7 per share. Peterson is annoyed to know that Baby Land missed the opportunity to purchase the land in Mexico given that Baby Land is eagerly looking for more profits. While recognizing that Baby Land needs to generate more profits, Peterson is very concerned that outsourcing to Mexico would tarnish Baby Land's good reputation. Therefore, Peterson plans to make a proposal at the coming annual shareholding meeting. To save money, she wants to have the proposal included in the management proxy circular. The proposal is as follows:

WHEREAS:
The company's shareholders are concerned about the potential for 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:
Article 10 of Baby Land’s bylaws is amended as follows: The board of directors 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 Peterson 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: [20 MARKS]

(a) Her legal grounds and the likelihood of success;
(b) The type of legal proceeding available;

(ii) Discuss legal issues regarding the proposal, including any legal challenge that the board of directors might raise and any advice to Peterson. [10 MARKS]
QUESTION 2

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 “Abbey, Betty & More.” According to the written partnership agreement, Abbey will contribute $80,000 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 $80,000 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 Darren, the sole shareholder and director of Gourmet Inc., which has been Abbey, Betty & More’s major supplier.

One day in the second year, Betty makes a phone call to Gourmet saying the shop will not continue ordering any Macadamia Hazelnut 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 Macadamia Hazelnut 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 Macadamia Hazelnut for $600. 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 ($50,000) on the purchase of a mini-truck from an auto-dealer, who is Abbey’s husband. The market value of the truck is $20,000. 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 Abbey, Betty & More. The competition reduces the partnership revenues by 30%. The partnership is now short in cash to pay its account payable, including the amount of $600 owed to Gourmet for the 20 boxes of Macadamia Hazelnut. Gourmet wants Claire to pay the overdue debt.

(i) Would Claire be liable for the $600 owed to Gourmet? Why or why not? [15 MARKS]

(ii) Betty has come to you for legal advice on the best way to sort out her problems with Abbey. Explain whether her wishes are legally viable and recommend any other possible legal remedies. [10 MARKS]

(a) Is Betty entitled to get a salary? Why or why not?
(b) Can Betty get out of the partnership?
(c) Is there any other remedy available? Will she succeed?

(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]
QUESTION 3: Answer ONE of the two questions [10 MARKS]

(i) In this course, we have seen Facebook's dual-class share structure. Many other well-known American technology companies including Google, Linkedin, Yelp, and Groupon have featured dual class structures. Quite many important Canadian companies such as Telus also have dual classes of shares. It has been estimated that 8% of companies listed on the Toronto Stock Exchange adopt a type of dual-class share structures. In recent years, the dual-class share structure has become a controversial issue, in particular for public companies. Discuss the pros and cons of the dual-class share structure, and why it is controversial particularly for public companies. Discuss any corporate law mechanisms that can alleviate or aggravate the concerns of dual-class share structures.

(ii) The CBCA and provincial corporate statutes apply not only to publicly-held corporations but also closely-held corporations. However, in many respects, the governance concerns of publicly-held corporations are different from those of closely-held corporations. Explain the key corporate governance concerns in publicly-held corporations and closely-held corporations respectively. How do the different concerns possibly explain publicly-held corporations and closely-held corporations may have different causes of excessive CEO pay and different feasible mechanisms for shareholders to address the excessive compensation problem?

END OF EXAMINATION