NOTES:

1. This is an open-book 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 Connect course page. No electronic materials are permitted. Your laptop is permitted only if you are using ExamSoft.

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 in 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.
PART I: SHORT-ANSWER QUESTIONS

This Part includes eight 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.

Dory is an employee of Morro Bay LLP., a seafood business. Dory works at the sales department and is responsible for processing purchase orders. Dory is instructed by her manager that given environmental sustainability concerns, the firm has stopped any supply of wild-caught Atlantic halibut. Dory suffers from some memory problems. A long-term customer places an order of wild-caught Atlantic halibut; the customer purchased the same several times in the past. Dory accepts and confirms the order by fax. Morro Bay argues that the firm is not bound by the contract because Dory acts beyond her authority. Is Dory liable for breaching the warranty of authority to the customer? Why or why not?

QUESTION 2.

Arlo, Buck and Chuck are the founding shareholders of Good Dinosaur Inc. The three shareholders reach an agreement that they will vote unanimously in every shareholder meeting. Later, Chuck sells all of his shares to Libby; Arlo and Buck have no objection to the share transfer. In a shareholder meeting, Libby wants to vote differently from Arlo and Buck. However, Arlo and Buck argue that Libby is not allowed to do so because the agreement among Arlo, Buck and Chuck is a unanimous shareholder agreement under CBCA s. 146, which binds subsequent transferees of shares. Is the argument made by Arlo and Buck correct? Why or why not?

QUESTION 3.

Frozen Inc. has three shareholders, with Anna holding 55% of the voting shares, Elsa holding 25%, and Olaf holding 20%. The company’s board is composed of 3 directors. The company’s bylaws require straight voting and majority voting for director elections. Olaf seeks to change the bylaws for director elections. He assumes that he will certainly be able to secure at least one board seat if it is by straight voting and plurality voting. Is Olaf’s assumption correct? Why or why not?
QUESTION 4.

Gaston is a director of B&B Inc., a toy company making fairy and princess dolls. The company is looking for a new fabric supplier. In a B&B’s board meeting, Gaston recommends Rocco Inc., a fabric company in which Gaston is the controlling shareholder. Gaston is silent about his relationship with Rocco and he withholds the information that Rocco is near bankruptcy. Because of Gaston’s strong and persistent recommendation, B&B’s board finally approves a long-term purchase agreement with Rocco. A shareholder of B&B brings a derivative action against Gaston and the court finds Gaston accountable for the profits realized from the agreement. B&B’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.” Gaston seeks indemnity from the company. How likely will Gaston successfully receive indemnity? And why?

QUESTION 5.

McQueen is the CEO of Cars Inc., a company that produces self-driving cars. The company has been looking for ways to enhance the sensitivity of radar receivers. In the company’s annual meeting with its suppliers, McQueen met Mater, the CEO of a radar supplier company. Mater told McQueen that his company was seeking capital to develop super-sensitive radar receivers. McQueen thought that it would be a good investment and immediately decided to personally invest in the radar supplier. McQueen made a profit of $1 million in the first year of the investment. Doc, a shareholder of Cars sues McQueen in a derivative action. McQueen argues that he is not personally liable and the company suffers no harm. Is McQueen correct? Why or why not?

QUESTION 6.

Moana and Maui love indigenous artworks. They agreed to create a gallery to sell paintings and sculptures made by local indigenous artists. They decided to form a LP in which Maui is the general partner and Moana is the limited partner. They also agreed that Moana is not personally liable for any debts of the partnership under all and any circumstances. As they both were busy collecting artworks and contacting local indigenous artists, they forgot to register their partnership. The gallery is not doing well and soon unable to pay its debts. The gallery’s creditors want to go after Moana. However, Moana argues that she has no personal liability given her status as a limited partner and her agreement with Maui. Is Moana’s argument right? Why or why not?
QUESTION 7.

Sparrow, Salazar and Turner are partners of Caribbean Pirates LLP. When they initially formed the partnership, they orally agreed to share equally in the profits of the business. One day, they held a meeting to distribute profits for the first time. Sparrow and Salazar believed that Turner contributed very little to the business. Over Turner’s strong opposition, Sparrow and Salazar passed a resolution that Sparrow and Salazar each would receive 45% of the profits and Turner would get 10%. Sparrow and Salazar justified their profit distribution decision on the basis that the majority rules in terms of the internal governance of the partnership. Are Sparrow and Salazar correct? Why or why not?

QUESTION 8.

Incredibles Inc. has eight directors, five of whom are members of a single family (a father, a mother, and three children). The corporation decides to purchase land owned by the father at a market price. At a properly noticed board meeting, the father-director discloses his interest prior to the vote on the purchase. The purchase is then approved by a vote of 6 to 1. The father abstains from voting. His wife and three children vote in favor of the purchase. At the annual shareholder meeting held soon afterward, the purchase is ratified by a 36-to-24 vote of the shareholders including the father, his wife and children. Is the transaction valid? Why or why not?
PART II: LONG-ANSWER QUESTION

Camazon is an online retail company. It is a closely-held corporation incorporated under the CBCA. The company has a three-person board. Camazon has two classes of shares outstanding: common shares and preferred shares. Its common shares are owned by Anders (owning 55% of the class), Brogan (owning 15% of the class), Cortez (owning 15% of the class) and other three shareholders (together owning 15% of the class). Its preferred shares are owned by Destin, Ernest, and Fabrice. None of the preferred shareholders own common shares. The preferred shareholders are entitled to a cumulative annual dividend of $100 per share, to be paid before any dividends are declared on the common stock. Camazon’s articles of incorporation provide that, the preferred shares are non-voting and non-redeemable; however, if dividends on the preferred stock are not paid for more than two years, all voting rights are vested exclusively in the preferred shareholders until all dividends in arrears have been paid.

Camazon’s three directors, Anders, Brogan and Cortez, sought to build up the company’s reserves for corporate expansion and therefore did not declare any dividend in the past three years. With the retained profits, Camazon acquired a large but old warehouse to store its merchandise. The warehouse was in need of some significant updates for safety concerns. After consideration at a properly noticed board meeting, the board of directors passed a resolution to postpone its warehouse renovation project by six months and not to purchase fire insurance before renovation. Anders and Brogan voted for the resolution while Cortez voted against it. Anders and Brogan acted out of the fear that they could be ousted by preferred shareholders as the company had not paid any dividend in more than two years. Anders and Brogan planned to pay dividends in arrears with the amount made available by delaying the renovation and insurance purchase. Subsequently, before any payment of dividends, a fire occurred, causing damage in the amount of $250,000.

The preferred shareholders had been upset with the board’s failure to pay any dividends in more than two years. After the fire incident, they believed that the board led by Anders was totally incompetent. Destin had a free online consultation with a corporate lawyer for advice on how to protect his rights and interests. After the consultation, Destin sent a written notice to the board requisitioning a special shareholder meeting. The purpose of the special meeting was to remove incumbent directors and elect new ones. The three directors refused to call a special shareholder meeting. Destin texted a message to Ernest and Fabrice saying “Let’s have a shareholder revolt. Take our company back! Join the fight?” Ernest and Fabrice both replied, “Sure, brother!” Destin then texted “10 am tomorrow, Anders’ office. Fire!”

The next morning, before taking the elevator to Anders’ office, Destin jotted down on a scrap of paper that “Anders, Brogan and Cortez are removed from office immediately. Destin, Ernest and Fabrice are elected as new directors.” Destin, Ernest and Fabrice signed under the statement. When arriving in Anders’ office, Destin announced the statement written on the paper. Anders laughed and said, “Your action is super stupid and invalid.” Destin replied, “Are you sure? You’d better consult your lawyer.” Anders walked out of the office building with great rage.
Destin, Ernest and Fabrice (the “Destin Bunch”) assumed that their shareholder revolution was successful and started to act in the capacity of director. Without any delay they held a board meeting. Ernest and Fabrice needed to leave halfway through the meeting, but they told Destin that he had their proxies to carry out their plan. Destin signed for himself and on behalf of Ernest and Fabrice a board resolution recommending that the articles of incorporation be amended to provide that the common shares be made nonvoting and permanently vesting all voting rights in the preferred shareholders. Destin then signed for himself and on behalf of Ernest and Fabrice to approve the amendment as a shareholder resolution. Destin then filed an amendment to the articles of incorporation through the government’s online filing system.

In the afternoon of the same day, Destin phoned Camazon’s auditor in respect of the company’s financial ability to pay all of the dividends in arrears on the preferred shares. On the phone, the auditor told Destin that the company probably would be unable to pay off a bank mortgage coming due. Destin believed that he shall be able to find other sources of financing. Destin then signed, on behalf of himself, Ernest and Fabrice, a board resolution to pay all of the dividends in arrears on the preferred shares. The payment date was scheduled on the last day of the following month. In the evening, Destin, through his personal contact, obtained a bank loan for the company; the loan will not come due for over a year.

The next day after the Destin Bunch’s rebellion, Anders, Brogan and Cortez (“the Anders Bunch”) held an emergency meeting. They believed that all of the Destin Bunch’s acts were invalid. The Anders Bunch believed that they themselves remained as Camazon’s directors. The Anders Bunch passed a board resolution to insert two new provisions in the company’s bylaws. The inserted provisions are read as under:

“Directors can only be removed with cause.”
“Directors shall hold office for a term at the close of the third annual meeting of shareholders following the election.”

Zara is a common shareholder. She is very disappointed about the fight between the Anders Bunch and the Destin Bunch. She is particularly upset about no dividends on the common shares. She is concerned about her situation in the company. Give Zara your advice on what rights and remedies she has and what actions she may take. [60 MARKS]

END OF EXAMINATION