

AGN:  
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# **BUSINESS ASSOCIATIONS**

**FOUR HOURS.  
THIS IS A CLOSED-BOOK EXAM.**

Try to show thought and critical analysis of the materials and issues dealt with in the course.

DO read the questions carefully and think about your answers before beginning to write.

DO refer to statutory provisions, cases and other materials where appropriate. If you make general statements, try to back them up with specific references.

DO NOT use abbreviations unless you explain what you are using them to stand for.

DO NOT make assumptions in answering the hypothetical.

DO explain what further information you might need in order to answer the question properly.

DO write legibly and clearly.

**You will get credit for following these instructions, and may be penalized for failing to do so.**

The Phoenix family owns a number of businesses in Arcadia (which is a state in the US). Ajatar is the head of the family and the entrepreneur who established the various family businesses. Because of his success and confidence in his own business skills Ajatar expects that the other family members who are involved in the family business (Bennu, Cerberus, Drac and Firedrake) will do what he says and that the family members who are not actively involved in the family business (Griffin, Hob and Imugi) will be grateful for the money he chooses to send their way.

Phoenix Enterprises Inc. (Inc.) is the holding company of the Phoenix Group which includes Phoenix Hotels Inc. (Hotels), Phoenix Hotel Supplies Inc. (Supplies) and Phoenix Family Farms LLC (LLC). Ajatar is the President of Inc., Hotels and Supplies, Bennu, who is an accountant, is the Chief Financial Officer, Cerberus, who is a lawyer, is the Secretary, and Drac, who has studied marketing, is Vice President for Marketing. All four are also directors of the corporations. The corporations also have a number of non-management directors. Firedrake, who studied agricultural science, is the Managing Member of LLC.

Inc has three classes of stock: Preferred Stock, which has a preferential dividend and voting rights and is owned by a group of outside investors (holders of this stock have 20% of the voting rights that can be exercised at stockholder meetings), Class A stock which is owned by the family members actively involved in the business (Ajatar, Bennu, Cerberus, Drac and Firedrake) and which has voting rights (holders of this stock have 80% of the voting rights that can be exercised at stockholder meetings — Ajatar has 60% of the total voting rights and each of the others has 5%), and Class B stock, which does not carry voting rights and is owned by family members who are not involved in the business, including Griffin, Hob and Imugi.

Hotels is wholly owned by Inc. Supplies and LLC are owned by members of the family, although Griffin, Hob and Imugi have no ownership interest in Supplies or LLC .

For a long time the Phoenix Group has been managed to maximize the revenues of Supplies and LLC. For example, Supplies has long-term contracts with Hotels to provide hotel supplies, and the contract prices are much higher than Hotels would need to pay other providers for the same items. Hotels is really Supplies' main customer.

Similarly LLC's fine produce is sold to Hotels at prices which are favorable to LLC — Hotels could obtain produce for lower prices from other vendors. But LLC does have a number of other customers who are happy to pay the high prices for quality produce. Firedrake is able to manage LLC's business without too much interference from the rest of the family because they are not very interested in farming. One day a friend of Firedrake's who farms land nearby tells Firedrake that he is planning to sell his farm. Firedrake decides that he would like to buy the farm so that he can experiment with some new farming techniques he has been reading about.

Griffin and Hob have no real interest in business, but they do love to cook and they have entered into a contract with the Xtra Food Group (Xtra) which is in the business of lending money to people who run their own restaurants (selling a wide range of different types of food and styles of cuisine) on premises owned by Xtra. The contract provides that Xtra will lend Griffin and Hob a sum of money to help them get their restaurant started, that Griffin and Hob will provide all of the kitchen fittings and equipment and that Xtra, Griffin and Hob will share the profits of the restaurant. In order to make sure that the restaurant is successful Xtra sends a supervisor to the restaurant once each month to see what is going on, and to ask Griffin, Hob and their staff for information. Griffin and Hob also provide weekly financial reports to Xtra. Without consulting anyone and in order to help Griffin and Hob, Bennu agreed that Hotels would guarantee Griffin and Hob's performance of the contract with Xtra, and he persuaded Cerberus (while Cerberus was distracted by lack of sleep because he has a newborn daughter who cries all night) to sign a copy of a (forged) Board resolution of Hotels approving the giving of the guarantee.

Hob hired Jac to work in the restaurant because Jac has a reputation as an innovative chef. After Hob and Jac developed a successful series of cooking seminars Hob offered Jac a share of the profits of the restaurant. Unfortunately, Jac agreed to buy some very expensive kitchen equipment from Kool Kitchens without consulting either Griffin or Hob. They think the equipment is unnecessary and they should not have to pay for it. And they also say Jac should leave the restaurant immediately.

Recently Ajatar has begun to feel tired. He would like to retire soon and begin to travel the world without having to worry about the business. Bennu thinks he is Ajatar's

logical successor as President, but the others do not agree. The Very Large Conglomerate (VLC) has recently approached Ajatar to see if they can either acquire Ajatar's shares in Inc. or agree to a merger with Inc. whereby VLC would offer to buy all of the shares in Inc. Ajatar responds "Why would you want to buy all of the shares when you can get control by buying mine?"

**Answer the following 4 questions, explaining (where applicable) what further facts you would need to know and giving reasons for your answers:**

1. (25 points) Griffin, Hob and Imugi feel that they have not been treated very well by their family: they have not been involved in the family business and they think that they should have been receiving higher dividend payments (the others seem to have a much more luxurious lifestyle than they do). Are there any legal claims they can bring based on these facts?

2. (25 points) What legal issues should Ajatar, Bennu and Firedrake be worrying about?

3. (25 points) What issues are raised by the arrangements for Griffin and Hob's restaurant? In your answer you should analyse the relationships between Griffin and Hob and Griffin and Hob and (a) Xtra, (b) Jac and (c) Kool Kitchens.

4. (25 points) **Either:**

(a) Discuss the following statement:

The clearer and more uniform a rule is, the more easily it is regarded as a formality that can justifiably be manipulated so long as compliance with its explicit formulation is maintained

Jan Deutsch, quoted on the class blog,

**Or**

(b) Discuss the Business Judgment Rule. Is it a rule? Do you think it encourages good business judgment?