

BUSINESS ASSOCIATIONS

THREE 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 question 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.

Arcadia and Urbania are states in the US.

Ronen, Inc. is a corporation incorporated in Arcadia, which carries on business as an Internet Services provider (ISP). Its shares are listed on the Arcadian Stock Exchange (ASE). Adam is the President and Chief Executive Officer (CEO) of Ronen, Belinda is the Chief Financial Officer (CFO) and Charles is the Vice President for Marketing. Adam, Belinda and Charles are also directors of Ronen. Dan and Edith are outside directors of Ronen. Dan is the President of the Arcadian Technical Institute (ATI) an institution of higher education. Edith is the President of the Arcadian Children's Organization (ACO) which is a non-profit organization which promotes the interests of children, and she is so busy with her work for ACO that she is often unable to attend Ronen's Board meetings. Ronen has made regular large donations over the years to ATI and ACO, but does not generally contribute to philanthropic causes, and does not bother to publicize donations to ATI and ACO because the Board does not want to have to deal with requests for donations from other organizations. ATI has established a Chair of Internet Studies in Adam's name. Belinda is a keen supporter of the Arcadian Opera Company, and Ronen also makes annual donations to support the Opera Company.

A while ago, Adam suggested to Belinda and Charles that he was considering moving to OCTY, Inc, a competitor of Ronen. OCTY, Inc. is a corporation incorporated in Urbania, and its shares are also listed on the Arcadian Stock Exchange. Belinda and Charles urged Adam to stay with Ronen and asked him what it would take to persuade him to stay. Adam produced a draft "Executive Services Agreement" which he said he had obtained from Frank, an Executive Compensation Consultant. Frank, who was at college with Adam's son, had in fact only been working as an Executive Compensation Consultant for a few weeks at the time. The draft agreement had a ten-year "Initial Term" and provided for four additional ten-year "Renewal Terms". Under the terms of the draft agreement each Renewal Term would become effective at each ten-year interval unless the Board voted to the contrary or the Executive declined to renew. A decision by the Board to block renewal of the Agreement would require the approval of 4 directors. After the first renewal, Ronen would incur significant costs if the Board should terminate the Executive or even reduce or otherwise change his duties at any time during any ten-year renewal term. Even

if the Executive were terminated for cause he would still be entitled under the agreement to five years' salary.

Charles and Belinda discussed the draft agreement with Adam and Frank, and were reassured by Frank's representations that the terms of the agreement were quite standard for CEO contracts. The Board considered the draft agreement at a meeting which all of the directors attended. Adam, Belinda and Charles described the terms of the agreement to Dan and Edith, and explained that they all thought that Adam was so important to Ronen that they should approve the agreement. Frank did not attend the meeting, but Charles and Belinda reported what he had told them about the terms of the agreement being quite standard for CEO contracts. The Board voted unanimously to approve the agreement.

At the same meeting, the Board approved an agreement for Ronen to purchase a large and very expensive apartment close to Ronen's offices in the city center. The Board's resolution approving the purchase stated that the apartment would be for the purposes of entertaining Ronen's clients and so that Adam could stay there on days when it was inconvenient for him to make the long journey home to his country house. Adam later asked his wife, who runs an exclusive interior decorating business, to decorate the apartment so that it would impress Ronen's clients. He said that "no expense should be spared" and he agreed that Ronen would pay her a large fee for his work. After the work was completed Adam decided he would live in the apartment during the week and return to his country house at the weekend. He invited his wife and adult son and daughter to live in the apartment with him.

Some months ago, Charles attended a conference on internet businesses, where he happened to meet Gail, the Vice President for Research and Development at OCTY Inc. Charles and Gail decided that they had many interests in common, and they began to date. On dates they would discuss Ronen and OCTY, and they began to think that Ronen and OCTY should begin to cooperate in developing and marketing new products and services for their customers. Part of their reason for thinking about co-operative arrangements between the two businesses was that both firms had in place executive incentive arrangements which encouraged executives to develop new ideas. Charles and

Gail presented the idea to their respective CEOs without disclosing the fact of their relationship. Both CEOs liked the idea, and they began to negotiate a “Co-operation Agreement” between Ronen and OCTY. Under the terms of the Co-operation Agreement, Ronen and OCTY would split the costs associated with joint development of new projects, and they would agree to share any benefits produced by the new projects. The Co-operation Agreement provided that it did not constitute any relationship of agency or partnership between Ronen and OCTY, and that neither corporation would owe to the other any fiduciary duties.

At the beginning, the joint activities of Ronen and OCTY were carried out on OCTY’s premises in Urbana, but after a few months it became clear that it would be necessary to acquire new premises for the new joint projects, and so Ronen and OCTY leased a building in Arcadia. Charles and Gail moved into offices in the new building and hired new staff, and agreed to buy new equipment. For a while all went well, and Charles and Gail benefitted under Ronen’s and OCTY’s executive incentive arrangements, acquiring options to acquire shares at attractive prices. Charles and Gail exercised their options to acquire shares in Ronen and OCTY respectively. However, over time Charles and Gail found it difficult to control the costs of the operation. Luckily for Charles and Gail they were approached by the President of the Arcadian Stock Exchange and invited to help the exchange develop and market its services. Charles and Gail decided to move to the Arcadian Stock Exchange, because working at the exchange would give them a wonderful opportunity to develop the ideas they were working on. They encouraged some of their most valuable staff members to move with them. Meanwhile, Charles and Gail also decided to sell their stock in Ronen and OCTY because they knew that their recent activities had incurred significant costs without producing any concrete benefits for Ronen and OCTY. Ronen has informed OCTY that it is terminating the Co-operation Agreement, and that it refuses to pay any more contributions towards the expenses of the joint operation.

The Arcadian partnership statute is based on RUPA (1997 version) and its corporations statute is based on the Revised Model Business Corporation Act (RMBCA),

with some additional provisions. The Arcadian Business Corporation Act (ABCA) contains the following provisions:

§ 8.32 In exercising their functions, and in considering the best interests of the corporation, directors shall be entitled to take account of the public interest, and of the interests of the corporation's stakeholders including employees, customers, and local residents.

§ 8.40A An employment agreement between a corporation and any officer for a term of more than ten years is unlawful and void unless the agreement is approved in advance at a shareholders' meeting by a resolution adopted by a majority of the votes entitled to be cast at that meeting after full disclosure of all of the material terms of the agreement. The officer to whom the agreement relates and any related persons of the officer shall not be entitled to vote on a resolution to approve such an agreement.

The Urbanian partnership statute is based on UPA and its corporations statute is the same as the Delaware General Corporation Law.

Discuss the legal issues raised by these facts. In your answer, consider the risks of legal liability, if any, faced by Adam, Belinda, Charles, Dan, Edith, Gail, Ronen, OCTY, and the Arcadian Stock Exchange. In addition, explain what actions any of these persons could have taken to reduce the risks of legal liability.