

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.

Utopias Inc. (UI) is incorporated in Arcadia. UI is in the (profitable) business of developing and marketing video games. Its most successful game is a massively multiplayer online role-playing game called Infinitequest. Large numbers of players pay a monthly fee to fight dragons and other weird creatures online and to search for treasure. In Infinitequest the players can spend time to develop skills in making weapons which give the players who own them advantages in battle. Players who are successful in battle generally collect more treasure than players who are unsuccessful in battle (and winning battles with dragons is particularly profitable as dragons hoard lots of treasure). Sometimes players make agreements with other players to collaborate in developing and using weapons to maximize the amount of treasure they can collect. There is an active market in weapons outside the game. Some players are willing to pay significant amounts in US dollars for the best weapons.

Although Infinitequest has been very successful, UI's Chief Development Officer (CDO), Fred, has been worrying for some time about UI's main competitors, AdamOnline Inc. (AOI) and Terraforma Inc. (TI), which are both also incorporated in Arcadia. Fred believes that UI needs to diversify into new types of online activity, consistent with UI's business plan which includes plans to acquire and develop new game ideas. Fred set members of his team working on developing new kinds of online activity. Game developers at UI and elsewhere work differently from other types of employee. They hang out in toy stores, toy museums, arcades and bookstores, work odd hours and drink lots of sugary drinks and eat lots of unhealthy snacks. Fred has always ensured that UI has large supplies of sugary drinks and unhealthy snacks available for its game developers. Because UI's game developers are often out in the field researching new games they are encouraged to carry promotional materials with them about UI's games and to apply UI stickers to their cars.

George, an officer at Maxbank, which is a large Arcadian bank, approached Fred to see if UI would be interested on working on developing an online game for the bank which would educate players about financial matters and make the players feel well disposed to the bank. George explained that it was very important for financial

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institutions to build connections with young people who would be their future customers and that, as young people were spending increasing amounts of time playing online games he thought an online financial game could be very useful to Maxbank. Fred decided that it would be a really good idea for UI to get into a different type of game and agreed on the spot that UI would take on the project. However, at the next meeting of UI's Board of Directors, when Fred was presenting a description of his team's current projects the Board did not like the idea of the Maxbank game. Fred presented to the Board the results of the research he had carried out which showed that:

1. the financial game sector was new but growing rapidly;
2. there were very many financial institutions based in Arcadia which had not yet developed such games; and
3. such games would be very profitable for UI (based on George's comments about what Maxbank would be willing to pay UI for its work on a new game).

Some of the Board members thought that a financial game of the sort Fred described was too different from the sort of games that UI made. Some Board members thought that diversifying the sorts of games UI made could be useful in case consumers' tastes changed and that UI should be flexible, whereas others thought that the old games were the best and change was unnecessary. Some Board members thought that it would be undesirable for UI to identify itself too closely with the interests of financial institutions. The Board did not discuss the financial implications of the decision in any detail and after a very brief discussion instructed Fred to tell George that UI would not work on the new game.

At the same Board meeting one of the directors raised a question about whether UI should provide healthy snacks for the workers. The other members of the Board laughed at this idea.

Shortly afterwards, Fred learned that AOI had agreed to work on the financial game for Maxbank and that AOI was very excited about this new opportunity. AOI developed the game, and Maxbank has been very happy about the number of people who have been playing the game, and about their positive reactions to the game.

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Because Maxbank was the first financial institution in the area to develop such a game, Maxbank and AOI have received much favorable publicity. Maxbank has, as a result, found many new customers since the game was launched. A large number of other financial institutions have approached AOI with requests to develop other financial games. When Fred was interviewed on the Arcadian Television Network after these developments about his work in the games industry he made some very negative comments about UI's Board's lack of vision. A number of UI's shareholders who saw this interview later sold their shares in disgust. But, after some of UI's Board members commented publicly about the strong performance of Infinitequest, UI's share price increased again.

In a book store, on a Tuesday morning, one of Fred's team members, Bob, ran across Marge, an old friend from college. Marge told Bob that she was developing a program which would allow people to plan and visualize events such as weddings and other large parties online. Marge pointed out that often people who were planning a large event together might live far apart and it would be useful for them to be able to see possible locations for an event from a distance and collaborate on arrangements at a distance. Bob's fiancé lives on the other side of the country and he immediately understood that the program could be very successful. Marge said that she thought that in order to develop the program properly she would need access to resources she did not have, and that she was thinking of trying to link up with a large company to develop the idea. Bob told Marge that her program wasn't really the sort of thing that UI was interested in, but that he had contacts at TI and could help her sell her idea to TI. Bob was so distracted by thinking about all of the possibilities associated with Marge's program that when he was backing out of his space in the book store's parking lot he bumped into and injured a child. The child's parents saw the UI sticker on Bob's car and the UI literature strewn all over the inside of Bob's car and they have threatened to sue UI for damages in respect of the accident.

UI was not very happy about Bob's accident so Bob went to TI and negotiated new (very remunerative) jobs there for himself and for Marge. Bob and Marge will
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receive a proportion of the profits of Marge's program in addition to their generous salaries. TI is excited about Marge's program and is planning a new range of similar virtual reality programs. Bob likes working at TI: the atmosphere is very comfortable: TI's management is interested in new ideas; and TI provides healthy snacks for its game developers and has a well equipped exercise room with a professional trainer on site. Bob recently met with Fred and told him about his new job. Bob said he was sure that TI would have room for Fred and for his best and most innovative workers. Fred has been discussing the idea of moving to TI with TI and with some members of his team at UI. Fred has an idea for a new game based on politics that he is excited about, but which he thinks that the UI Board would be unlikely to want to develop.

UI's last profit figures were much less healthy than UI's Board had expected. Infinitequest now seems to be an aging game and UI desperately needs new ideas. Unfortunately, UI's game developers are generally disgruntled and, if Fred leaves with the best people on his team it will take a long time for UI to build up an effective team.

Answer the following questions (read all of the questions before answering any in order to avoid duplication in your answers), explaining what further facts you would need to know and giving reasons for your answers:

- 1.(15 points) If the UI Board decides to offer Fred as much money (and other inducements) as it would take to persuade him not to leave UI, would there be any risks of liability for the individual Board members (in relation to Fred's compensation), and, if so, what should the Board do to minimize these risks?
2. (15 points) If the UI Board loses Fred and his team members to TI, and UI's financial position declines as a result, can the UI Board take any legal action against Fred, his team members and/or TI ?
3. (15 points) Can the UI Board take any legal action against Bob, and/or Marge, and/or TI (in respect of Bob's and/or Marge's actions)?

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4. (15 points) Does UI have any liability in respect of Bob's accident?
5. (25 points) If UI's financial position declines, can unhappy UI shareholders sue UI's Board ? Describe what sort of claims the shareholders may want to bring against the Board and what problems the shareholders will encounter in trying to pursue these claims. In your answer, consider whether it would make a difference whether the Arcadian corporations statute was modelled on the Delaware General Corporations Law or the RMBCA.
6. (15 points) In *Re Walt Disney Derivative Litigation*, Chancellor Chandler made the following statement:

“Even where decision-makers act as faithful servants, however, their ability and the wisdom of their judgments will vary. The redress for failures that arise from faithful management must come from the markets, through the action of shareholders and the free flow of capital, and not from this Court. Should the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decisionmakers would necessarily take decisions that minimize risk, not maximize value. The entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware corporation would cease to exist, with disastrous results for shareholders and society alike. That is why, under our corporate law, corporate decision-makers are held strictly to their fiduciary duties, but within the boundaries of those duties are free to act as their judgment and abilities dictate, free of post hoc penalties from a reviewing court using perfect hindsight. Corporate decisions are made, risks are taken, the results become apparent, capital flows accordingly, and shareholder value is increased.”

Discuss this statement. In your answer you should evaluate this statement as a general matter, and discuss its application to the facts of the Walt Disney case and to the facts described in the hypothetical.